No. 18785

In the

United States Court of Appeals

For the Ninth Circuit

INTERSTATE PLYWOOD SALES CO.,
a corporation,
Appellant,

vs.

INTERSTATE CONTAINER CORPORATION,
a corporation,
Appellee.

APPELLANT'S BRIEF

Appeal from the United States District Court for the
Northern District of California
Southern Division

HONORABLE W. T. SWEIGERT, Judge

DUNNE, DUNNE & PHELPS
DESMOND G. KELLY
333 Montgomery Street
San Francisco 4, California

KOERNER, YOUNG, McCOLLOCH & DEZENDORF
JAMES C. DEZENDORF
JAMES H. CLARKE
8th Floor, Pacific Building
Portland 4, Oregon
Attorneys for Appellant

DAILY JOURNAL OF COMMERCE
20

SUBJECT INDEX

AUTHORITIES

Table of Cases

CASES—(Contd.)

CASES—(Contd.)

Other Authorities

No. 18785

In the

United States Court of Appeals

For the Ninth Circuit

INTERSTATE PLYWOOD SALES CO.,
a corporation,
Appellant,

vs.

INTERSTATE CONTAINER CORPORATION,
a corporation,
Appellee.

Appeal from the United States District Court for the
Northern District of California
Southern Division
HONORABLE W. T. SWEIGERT, Judge

APPELLANT'S BRIEF

JURISDICTION

This is an action for damages for breach of contract. It was filed in the District Court for the Northern District of California, Southern Division. Plaintiff-appellant is an Oregon corporation, and its principal place of business is in Oregon; defendant-appellee is a California corporation, and its principal place of business is in California. The matter in controversy exceeds $10,000 exclusive of interest and costs (R 151).

The case was tried on January 8-10, 1962. On May 16, 1962 the trial judge entered judgment in plaintiff's favor for $395,410.02 (R 66). On August 14, 1962 he

granted a partial new trial limited to a single claim of breach and the question of damages. He refused to retry questions of the validity and enforceability of the contract (R 89).

The partial new trial was held on December 3-7, 1962. On January 31, 1963 the trial judge issued an opinion holding that the contract was unenforceable. He did not rule on the question of damages at all (R 97). On March 21, 1963 he entered findings and conclusions (R 150) and judgment for defendant (R 161). On April 18, 1963 plaintiff appealed from the judgment (R 163).

The district court had jurisdiction under 28 USC § 1332 as amended. This Court has jurisdiction under 28 USC § 1291 as amended.

STATEMENT OF THE CASE

This is an action for damages for breach of a plywood sales agreement dated October 31, 1955 between plaintiff's predecessors[1] and defendant, under which plaintiff agreed to finance improvements to defendant's veneer plant at Red Bluff, California and market its production of veneer and plywood (Exh 1).[2]

At that time, defendant produced only digger pine

1. Fred Fields and F. A. Johnson, who own all of plaintiff's stock. It was assigned to plaintiff with defendant's consent on November 5, 1955 (R 29; Exh 1, par 11; 1 Tr 25-26, 97; 2 Tr 27).
References to the transcript of the first trial are indicated as "1 Tr". References to the transcript of the partial retrial are indicated as "2 Tr".
2. The contract is reproduced as Appendix B (post 90). Plywood is made by gluing sheets of veneer together (1 Tr 52-53, 134).

veneer (1 Tr 47, 113, 118, 134; 2 Tr 348) and wanted to manufacture plywood from digger pine and perhaps other species (2 Tr 93-95). Pine veneer was not regarded as competitive with douglas fir (1 Tr 57) and digger pine plywood was a new product of uncertain acceptance in the market (1 Tr 56-57; 2 Tr 94). Defendant had no plywood machinery (1 Tr 114; 2 Tr 348), and none of its officers had any experience in the plywood industry (2 Tr 348-349). Its production capacity was about 50,000,000 square feet per year on a ⅜″ basis (1 Tr 54; 2 Tr 276).

Under the contract, plaintiff supplied both financing and a marketing service to dispose of defendant's contemplated production and was granted the exclusive option to purchase 95% of its production at a 5% discount from the net mill price to jobbers.[3] The contract was for five years, and on June 14, 1960, in accordance with its terms, was renewed by plaintiff for an additional five years (R 29, 152; Exh 4; Exh 1, par 2).

Shortly after the contract was executed, defendant commenced to manufacture digger pine sheathing (1 Tr 113-114, 118-119, 133-135; 2 Tr 347-349)[4], but it could not be sold (1 Tr 46-48, 49, 56-57), and after 18 months or two years defendant commenced to make sheathing from douglas fir (1 Tr 59-60, 119-120).

3. Jobbers are wholesalers with warehouses (2 Tr 198, 406).

4. Sheathing is a construction grade of plywood and has at all times constituted the bulk of defendant's production (1 Tr 119-120, 134; 2 Tr 221, 466).

On November 14, 1960, after attempting unsuccessfully to buy the contract from plaintiff and negotiating secretly with one of plaintiff's customers for a substitute for plaintiff's exclusive sales agreement (Exhs 2, 47; R 106; Schwab Dep 22-23; 2 Tr 433-434), defendant suddenly repudiated the contract and refused to accept further orders from plaintiff (R 30; Exh 5; 1 Tr 98-100, 101-102; Schwab Dep 25-26). Plaintiff seeks damages for loss of future profits resulting from defendant's repudiation of the contract.

During the life of the contract before repudiating it, defendant, without plaintiff's knowledge or consent, sold a substantial part of its production directly to third persons, mostly plaintiff's own customers, in excess of the 5% reserved in the contract for local sales and footage released by plaintiff in the spring of 1959 (Exh 6A, 24). Plaintiff also seeks damages sustained by reason of these outside sales.

The trial court first held that the contract was valid and enforceable and entered findings and conclusions and judgment in favor of plaintiff for $395,410.02, including damages for loss of future profits and resulting from outside sales (R 59, 66). On defendant's motion, it allowed a partial retrial "upon the issue of damages alone" (R 77). After the partial retrial, it refused to grant executory enforcement of the contract, because it concluded that a certain price formula in the contract

(the "five-mill formula") was incapable of application, as intended, to resolve occasional differences between the parties over the current market price of plywood (see R 115-116, 122). It also held that the outside sales did not breach any of defendant's obligations under the contract (R 120-122; see R 78). It refused to decide the issue of damages (R 122). Judgment was entered for defendant on March 21, 1963 (R 161).

The Contract

a. The opening paragraph recited:

"WHEREAS, FIRST PARTY [defendant] owns and operates a veneer manufacturing plant located at Red Bluff, California with an estimated productive capacity of veneer of approximately three million square feet per month on a three-eights inch rough basis; and

"WHEREAS, FIRST PARTY desires to make arrangements for the addition of certain additional equipment in its veneer plant so that it will be in a position to produce sheathing and other grades of plywood from the veneer it is now manufacturing; and

"WHEREAS, SECOND PARTY [plaintiff] desires to make arrangements for the marketing throughout the United States and elsewhere of the plywood to be manufactured by the FIRST PARTY, and during the period while the additional equipment is being acquired to market for the FIRST PARTY its veneer production; and

"WHEREAS, SECOND PARTY has sales outlets for veneer and sheathing plywood and customers to serve in principal markets throughout the United States and elsewhere, and SECOND PARTY also has

> the necessary finances to acquire the necessary additional equipment to convert the veneer plant to a sheathing plywood manufacturing plant and are able to acquire either new or used equipment to complete the facilities of the FIRST PARTY:"

b. Defendant gave plaintiff the "exclusive option" to buy 95% of its production (Par 1), and plaintiff was obligated

> "* * * so far as possible * * * to provide the FIRST PARTY [defendant] with orders for 95% of the output of its veneer or plywood. * * * at the 'market' price of veneer or plywood * * *" (Par 3)

and to acquire and advance the price and installation expense of plywood manufacturing equipment (Pars 14-16).[5]

Paragraph 5 required that plaintiff

> "* * * as near as possible, supply orders to FIRST PARTY [defendant] to take into account the logs available for veneer and plywood production by FIRST PARTY. * * *"

c. The five-mill formula provided:

> "* * * The parties agree that the published market price listed to jobbers by the following plants shall be for the purposes of this agreement the 'market price':

5. This and all other loans to defendant were repaid before this action was commenced (Exh 49; 1 Tr 26-28, 184-185).

United States Plywood Corporation, Anderson, California
Sonoma Plywood Company, Sonoma, California
Tri-State Plywood Company, Santa Clara, California
Industrial Plywood Corporation, Willits, California
Plywood, Inc., Klamath Falls, Oregon

It is recognized that the afore-mentioned mills publish price lists at different intervals and vary their prices by granting additional discounts. It is intended that the SECOND PARTY [plaintiff] obtain orders for the FIRST PARTY [defendant] at the average of such market price, taking into account the changes referred to herein." (Par 3)

d. Paragraph 6 gave defendant a limited right to dispose of production which plaintiff

"* * * shall find it is unable to sell * * * for any given month, * * * through brokers, other than SECOND PARTY [plaintiff], or through its own sales organization for that month."

e. Paragraph 8 provided:

"It is understood that SECOND PARTY [plaintiff] will normally take orders for shipment from 15 to 45 days after the order is taken and that SECOND PARTY may be required to commit FIRST PARTY [defendant] to a price for future shipment. FIRST PARTY shall accept such commitments for a period of up to thirty (30) days and shall be bound to protect the SECOND PARTY on the price on orders accepted for a period of thirty (30) days from the date of the order."

f. Paragraph 10 provided:

"The price of plywood purchased by the SECOND PARTY [plaintiff] from the FIRST PARTY [defendant] hereunder shall be the 'market price' to jobbers, less 5% and an additional 2% if the invoice is paid in accordance with paragraph 4. The price of veneer purchased by SECOND PARTY from FIRST PARTY hereunder shall be the 'market price' less 5% and an additional 2% if the invoice is paid in accordance with paragraph 4. The starting 'market price' hereunder is as set out on Exhibit 'A' attached hereto. In the event said veneer cannot be sold at the prices set forth on Exhibit 'A', the price shall be fixed by arbitration under paragraph 18 if the parties themselves cannot fix the market price."

g. Definition (d) provided:

" 'Market price' to jobbers shall mean the mill price less the (five) 5% functional discount to jobbers.

"Example:

Mill price	$100.00
Less—Functional Discount to plywood jobbers (5%)	5.00
Market Price (listed to jobbers)	95.00
Less Cash Discount (2%)	1.90
Balance	93.10
Less additional discount to SECOND PARTY [plaintiff] hereunder	4.66
NET TO MILL	$ 88.44"

(emphasis in original)

h. Paragraph 18 provided:

"It is hereby agreed that in case any disagreement or difference shall arise at any time hereafter between the parties hereto in relation to this contract either as to the construction or operation thereof, or to the respective rights and liabilities thereto, such disagreement shall be submitted to the arbitration of three persons, one to be appointed by each party to this agreement, and the third to be appointed by the two so appointed. * * * Arbitration hereunder shall be governed by the laws of the State of California relating to arbitration. * * *"

The Five Mill Formula

The trial court found in both opinions that the contract price of plywood under the agreement was the general market price, and the five-mill formula was to be used only when the parties could not otherwise determine it (R 82-83, 102, 110, 119-120; 2 Tr 30-31, 326-327). Despite the language of the contract, it found after the partial retrial that the formula was intended to apply to both digger pine and fir plywood (R 98; 2 Tr 38, 46, 86, 102-103, 327). The listed mills were those nearest and generally similar to defendant's mill (2 Tr 37, 102, 171).[6]

The formula was adapted from a form of agreement used by United States Plywood Corporation which Mr. Johnson brought to the meeting at which the contract

6. These were all sheathing mills, but none used digger pine (2 Tr 169-170).

was discussed, drafted and executed (Exh 29; 2 Tr 84, 101). From the outset, the formula was not used and was never referred to by the parties, because some of the named mills were out of business and others did not publish price lists (R 101; 1 Tr 61, 65-66, 72-73; 2 Tr 63-64, 78-82,[7] 171-175, see 323, 333, 363).[8]

The Determination of Market Price under the Contract

During the life of the contract, plaintiff presented orders received from its customers to defendant almost daily which called for sales at market price (2 Tr 320). Each item on an order would be discussed by the respective sales managers of plaintiff and defendant, and it would be individually confirmed (1 Tr 68-70, 135-137; 2 Tr 317-320, 360-362, 384, 385; Smith Dep 5-6). Only then would plaintiff commit itself to its customer; otherwise it might be unable to fill the order (2 Tr 325).

The parties never consulted or mentioned the five-mill formula during the period of more than five years before defendant repudiated the contract (R 82, 103, 115; 1 Tr 137, 168-169; 2 Tr 332, 357, 362-365, 366-367). Instead, they determined the current market price of each item in a contemplated order from all available sources of market information, including (1) prices

7. Industrial Plywood published price lists irregularly which made no reference to discounts (2 Tr 78-79). It is not customary to do so (2 Tr 64, 79).
8. United States Plywood Corporation published a general price list, but none specifically for its Anderson mill (2 Tr 172-173). Its price list was referred to by the parties (1 Tr 90-91, 138, 155; 2 Tr 363) as were such other lists of these and other mills as might be available from time to time (1 Tr 91-92, 94, 138-141, 155-156).

quoted by other mills; (2) general market information acquired from their daily contacts in the industry; (3) market publications, including Crow's weekly reports; (4) current experience with their existing price list and the state of defendant's order file; (5) seasonal price fluctuations; and (6) the proposed method of shipment and other circumstances of the particular order (R 102-103, 104, 107; 1 Tr 61-73, 90-94, 135-137, 155-156; 2 Tr 318-320, 323-324, 329, 360-364, 368-369, 385-386; Smith Dep 17-18).[9] The trial judge found:

> "Looking to the conduct of the parties themselves during nearly five years of daily operation under the contract (before any controversy arose) and to conditions and practices of the industry presumably known to the parties upon execution of the contract, the evidence shows without dispute that neither party ever referred to the five mill formula as such, or to the apparent unworkability of that formula, or to the effect of any such unworkability upon the contract. In fact, they did not refer to the contract at all except as hereafter noted. Actually, the parties proceeded to endeavor to ascertain market price from transaction to transaction by reference to other, general market information sources." (R 102-103)

The parties agree on the meaning of the term "market price". Defendant's sales manager, Mr. Smith, testified that it is "the highest price that the material could be sold for" (2 Tr 356) and the "price at which [it]

9. In the industry, these are the factors usually considered in determining a price (2 Tr 387).

moves" (Smith Dep 19). Plaintiff's sales manager, Mr. St. Onge, described it as "the actual going market price" (2 Tr 324) and the "moving market" (1 Tr 62, 64, 67; see also 2 Tr 303, 319-320).

> "* * * it was the price that was generally being used by buyers and sellers in the industry at that time. * * *" (2 Tr 326-327)

Sometimes, the parties could not agree about the current market price. These disagreements were usually of short duration (2 Tr 359) and were described by defendant's sales manager, Mr. Smith, as occurring "very rarely" (1 Tr 137).[10] They would arise when a customer insisted on a lower price than that initially quoted. The matter was usually resolved by making an investigation of the market (2 Tr 359), and plaintiff would try to place the order at the price desired by defendant or seek more time or secure a change in specifications, or it might negotiate a different price (2 Tr 321, 354-356, 357, 381-382). Sometimes the sale would ultimately be made (1 Tr 62, 64, 67). Plaintiff did not, however, insist upon or seek to arbitrate or litigate the propriety of any specific price level; if it could not agree with defendant about the market price, it would merely refrain from exercising its option (R 105; 2 Tr 320-322, 332, 334-335, 358-359, 367).

10. They became "many" in his testimony at the partial retrial (2 Tr 359).

Defendant filled all orders which it accepted before it repudiated the contract (1 Tr 55, 142; 2 Tr 323, 354, 425) and failed to accept them only when there was a disagreement over market price (2 Tr 323).

Market price was sometimes difficult to determine. During the period involved, there was increasing production capacity in the industry (1 Tr 92; see 2 Tr 461-469), and the market price of plywood slowly declined (1 Tr 82, 85-86, 122). On occasion, it would fluctuate from mill to mill (R 103-104; 1 Tr 41-42, 63-64, 69, 76, 122; 2 Tr 223-224, 333-334, 385; McNeil Dep 13). The industry was subject to seasonal price variations, and price differences among the products made by a single mill would affect its overall return (1 Tr 93; 2 Tr 500-501, 506, 519-520). There were, furthermore, variations between published and actual prices (2 Tr 509) and mill price differences were sometimes reflected in discounts which the parties considered in determining the market price (1 Tr 171). In a falling market it is difficult to determine the market price (Smith Dep 18-19), and it becomes difficult to sell plywood, because warehouse customers are reluctant to buy until the trend is reversed (1 Tr 142-143; 2 Tr 224; Smith Dep 12-13, 17; McNeil Dep 13-14).[11]

---

11. In his second opinion, the trial judge found that market price was "difficult, if not impossible" to ascertain. He did not find that it was not legally ascertainable or that the parties did not ascertain it (R 105, 115). In his first opinion, he found that it was legally ascertainable (R 84).

Despite these conditions, plaintiff marketed roughly three quarters of defendant's total production during the period 1955-1960 (Exh 6A, 17, pp 2-3), and defendant's witnesses testified that it sold nearly all of the rest to others on the terms and at the net prices available to plaintiff under the contract (2 Tr 388, 420-421; see 1 Tr 144, 151).

The market price of plywood is characterized by a range or spread within which sales are being made at any time (1 Tr 158; 2 Tr 219, McNeil Dep 9). The trial court found after the partial retrial that defendant's quoted prices were consistently at or near the top of that spread (R 104).[12] Defendant's prices were consistently higher than those of Tri-State Plywood Co., one of the five mills listed in the formula (Exh 15, 17, 25).

Defendant's employee, Mr. McNeil, who was formerly plaintiff's sales representative in Los Angeles and went to work for defendant immediately after termination of the contract (2 Tr 232; McNeil Dep 18-19), testified to the competitive problem which this practice caused. The spread constituted the competition which he was selling against (2 Tr 219-220; McNeil Dep 9), and he was consistently undersold. Plywood was always available to his prospective customers elsewhere at a lower price, because he was quoting the top of the

12. The prices were not lower than those quoted by Crow's, which were always one week or more out of date (1 Tr 140; 2 Tr 223; McNeil Dep 12).

spread (2 Tr 216, 218, 219, 220-222, 227; McNeil Dep 8-9, 14-15; see 1 Tr 74-75).[13]

Other factors which limited plaintiff's sales were that defendant tried to restrict itself to ⅜" production in certain grades only (2 Tr 221; McNeil Dep 10-11); defendant would permit only a two week order file, while many prospective customers needed 60 to 90 days delivery (2 Tr 211, 216, 384; McNeil Dep 5, 8-9);[14] and defendant failed for some time to secure approval of its product by the Douglas Fir Plywood Association (Smith Dep 10-11).

Plaintiff complained that defendant was insisting on prices which were not competitive in the market (Exh 20; 1 Tr 76; 2 Tr 180, 300-301, 303-304, 321, 356, 398-399; Smith Dep 9-10). Mr. Smith, however, resisted plaintiff's efforts to secure lower quotations (2 Tr 356, 398-399) and complained of the lack of orders at prices which he thought reflected the current market (see 2 Tr 158, 180, 233; McNeil Dep 19-20; Smith Dep 8-10; Schwab Dep 19, 20). The discussions usually related to mill price rather than discounts (2 Tr 329, 399, see 365), but in 1957 and later when other mills commenced to allow additional discounts to jobbers they discussed these added discounts; plaintiff pointed out that they made the quotations noncompetitive, and Mr.

13. He complained to Mr. St. Onge that the price was not competitive (2 Tr 226-227; McNeil Dep 14-15).

14. A short order file is particularly bad in a falling market (1 Tr 171-172).

Smith conceded that they amounted in net effect to a price reduction by the mill (1 Tr 162-163; 2 Tr 335, 336-338, 365-367). This often resulted in a reduced quotation (1 Tr 171).

The Discount System

The established discounts from mill prices at the commencement of the contract were 5% to the jobber and 2% for cash. If a mill used a sales company, an additional 5% was deducted as its compensation. The mill received mill price less 5%, 2%, 5%, while the jobber paid the sales company mill price less 5%, 2% (Exhs 12, 13; 1 Tr 107, 109, 161-162; 2 Tr 327-328).[15] This was the system prescribed by the contract (definition "d"; 1 Tr 79).

Thus, any mill which could develop its own sales for less than 5% would wish to do so and retain the difference or pass part or all of it on to its customer. Direct sales by the mill at 5%, 5%, 2% will always undercut the prices of its contract sales company, because it is giving the sales company discount to the direct customer, while still receiving its entire anticipated net return (1 Tr 152-153, 165).

Commencing in 1957, as industry plant capacity expanded, jobbers in the eastern markets commenced to demand additional discounts of 2% or 3%. This be-

15. The amount of each discount is based on the net amount remaining after deducting all prior discounts (Exhs 12, 13; 1 Tr 158-160).

came established in the market, and by 1960 40% to 50% of plaintiff's sales of defendant's production were marketed in that area on such terms (1 Tr 79-81, 123, 154, 156-157; 2 Tr 54-62, 71-74, 330-331).[16] The contract treated these discounts as reductions from mill prices (par 3), and they were so regarded by defendant (2 Tr 366-367) and were considered by the parties in determining market price (1 Tr 171). They were also allowed to jobbers by sales companies out of their commissions (1 Tr 79-80, 83-84, 123).[17] They were not given at all in the southwest market, however, and by an agreed marketing plan plaintiff tried to make 60% of its sales for defendant in that area (1 Tr 85; 2 Tr 337-338; Smith Dep 21-22).

The Outside Sales

a. Paragraph 6 of the contract provided:

> "In the event SECOND PARTY [plaintiff] shall find it is unable to sell 95% of the output of FIRST PARTY [defendant] for any given month, SECOND PARTY shall, as soon as possible, but in any event give the FIRST PARTY a ten (10) day notice of the portion of the production of SECOND PARTY that it is unable to sell during any month. In the event SECOND PARTY gives such notice, FIRST PARTY shall then be free to sell that portion of its estimated output on the open market through brokers, other than SECOND PARTY, or through its own sales organization for that month."[18]

16. The jobber was keeping this additional discount and passing on his own 5% discount to the dealer (1 Tr 82).
17. The mills now extend these discounts to their sales companies (1 Tr 84).
18. The trial court found that the notice provision was disregarded by the parties (R 118).

b. Defendant's direct (outside) sales occurred primarily during two periods:

From May, 1956 through July, 1957 (15 months) such sales amounted to 12,783,742 feet, or 45.35% of defendant's shipments (Exh 24).[19]

From May, 1959 through December, 1960 (20 months) such sales amounted to 28,501,559 feet, or 39.70% of defendant's shipments (Exh 24).[20]

In March and April, 1956 (2 months) (when defendant first commenced production) such sales amounted to only 26,132 feet, or 5.02% of defendant's shipments (Exh 24).

From August, 1957 through April, 1959 (21 months) such sales amounted to only 1,640,819 feet, or 2.48% of defendant's shipments (Exhs 6A, 24, 44; Exh 17, pp 2-4; 1 Tr 187-189; 2 Tr 257, 260-262).[21]

c. Defendant made the direct sales when it felt that the two week order file on which it insisted was short. It did so, without advising plaintiff, at prices which it claimed at the trial were equal to or above those quoted to plaintiff. Initially, it did so in response to inquiries from prospective customers (2 Tr 422-424,

19. This period included defendant's commencement of fir plywood production (1 Tr 59-60, 119-120).

20. This figure includes sales to United States Plywood Corporation after May, 1959, some 8,088,156 feet of which had been released by plaintiff on defendant's agreement to extend the contract by an equal amount (Exhs 3, 6B, 21, 26). If such sales are deducted, net outside sales during this period amount to 20,413,403, or 32% of defendant's shipments. (Exh 17, p 4)

21. This included the period when eastern jobbers commenced to receive additional discounts (1 Tr 80; 2 Tr 54, 57, 71). Retail sales are excluded from the calculations (2 Tr 259).

427-429),[22] but its growing sales organization came to actively solicit orders (Exh 7, Schwab Dep 12; 1 Tr 11; 2 Tr 424). Defendant's direct customers were in many cases customers of plaintiff, who accounted for about 75% of the total amount of unauthorized outside sales (Exhs 42, 48; 2 Tr 291-292, 413, 424, 592-593). The principal one was United States Plywood Corporation, which bought some 16 million feet in excess of the released footage at discounts of 5%, 5%, 2%. This was a customer of plaintiff, and defendant knew it (2 Tr 413). Defendant's manager, Mr. Smith, admitted that if these orders had been referred to plaintiff, defendant's order file would have been increased (2 Tr 429).

d. During the initial period of heavy outside sales (May, 1956 through July, 1957) the average amount of orders on file with defendant each week was equal to 12.2 days' shipping requirements. During the second period (May, 1959 through December, 1960) the average level of unfilled orders from plaintiff on hand each week was equivalent to 9.8 days' shipping requirements (Exh 17, pp 6, 7; 1 Tr 190-191, 199, 201, 213-214; 2 Tr 264-267).[23] There was not a single week in which the mill was out of orders from plaintiff (1 Tr 213; 2 Tr 286).

22. Mr. Smith testified that they did so only when their order file was less than six days (Smith Dep 16). For various stated reasons, defendant would permit only a short order file not exceeding two weeks' production (1 Tr 63, 146, 166, 168; 2 Tr 211, 216; McNeil Dep 5, 8-9).

23. The figures were determined from orders on hand on the same day of each week during each period (2 Tr 286). The figures for the latter period exclude the authorized sales to United States Plywood Corporation (1 Tr 201; 2 Tr 266).

e. At the first trial, defendant's sales manager, Mr. Smith, testified unequivocally and repeatedly that outside sales were "primarily" and "normally" made to plywood jobbers, i.e., to persons to whom plaintiff would customarily sell at mill price less 5%, 2% (1 Tr 143, 146). At the retrial, he attempted to reverse his prior testimony and testified that 75% to 80% of two groups of invoices which he examined evidenced sales by defendant to other sales companies at discounts of 5%, 5%, 2% and 5%, 3%, 2% (Exhs 22, 23; 2 Tr 388-391, 394). However, when asked on cross examination to state from examining the 300 odd invoices the names of the "sales companies" to whom defendant had sold (2 Tr 401-402), he could identify only six. One was in fact an integrated operator which stocked plywood and performed a jobber function (2 Tr 403-404) and three of the others, whatever their nominal functional level, were admitted by him to be plaintiff's customers (2 Tr 405, 408, 410, 411).

The greatest volume of sales—more than 24,000,000 feet, including 8,000,000 feet released by plaintiff in May 1959—were made to United States Plywood Corporation, nearly all at 5%, 5%, 2%, and United States Plywood Corporation was admittedly a customer of plaintiff (Exhs 3, 6B, 21, 42, 48; 2 Tr 128, 413, 418-419). Total outside sales to plaintiff's customers (in excess of the released footage) were more than 20,000,000 feet

(Exh 48, see also Exh 42; 2 Tr 592-593). Nearly all of the footage sold to plaintiff's customers was sold at discounts of 5%, 5%, 2% or more (Exh 48).

Thus, most of the outside sales were to plaintiff's own customers at prices which, while assuring the mill its anticipated net return (or more), could not be matched by plaintiff. Total outside sales to all persons (in excess of local sales and released footage) amounted to about 30,000,000 feet or more, of which more than 80% was sold at discounts of 5%, 5%, 2% or more (Exhs 6A, 42, 48).

f. The trial court found that plaintiff knew defendant's capacity and production and concluded that it must have known that outside sales were being made from unordered production (R 79, 118; see 2 Tr 431). Defendant's witnesses testified that they told plaintiff generally of the outside sales (1 Tr 143-144, 153, 166), but Mr. Smith admitted that plaintiff was not notified of them or given an opportunity to have the business, saying that he feared that plaintiff might place the orders elsewhere (2 Tr 429). Plaintiff had no specific knowledge of the sales prior to the audit made after suit was filed (2 Tr 129-130, 133, 297-298, 299-300, 431). Although the release agreement required that plaintiff be given a copy of all sales to United States Plywood Corporation, none were supplied it (1 Tr 149; 2 Tr 128, 428).

Except for one occasion (which defendant promised not to repeat), plaintiff did not know that direct sales were being made to its own customers (Exh 18; 1 Tr 153-154; 2 Tr 129-130). Defendant, however, knew that this was plaintiff's customer (1 Tr 143, 146-147, 149; 2 Tr 129). Plaintiff protested when outside sales came to its attention. It objected orally to them (Smith Dep 14) and twice wrote to defendant, insisting that the contract would not work unless inquiries were referred to it, especially those from its own customers (Exhs 18, 19; 2 Tr 110-111, 114-115).

g. Plaintiff's costs of doing business were fixed, and commissions[24] it would have earned on direct sales made by defendant would have added to its net earnings, dollar for dollar (2 Tr 134-135, 313). They represented an absolute net loss to plaintiff resulting from defendant's direct sales.

The Trial Court's Procedure and Decisions

A.

On April 23, 1962, after the first trial, the trial judge rendered a memorandum decision in favor of plaintiff, and on May 16, 1962 the court entered findings of fact, conclusions of law and judgment in favor of plaintiff for $395,410.02 (R 59, 66). Thereafter, defendant moved for a new trial (R 67). Plaintiff moved to strike

24. In defendant's books they are consistently referred to as "commissions" (2 Tr 541-542).

the motion for failure to comply with the Federal Rules of Civil Procedure (R 72). On August 14, 1962, the trial judge issued a "memorandum of decision" sustaining the validity and enforceability of the contract (R 77). It held:

> "The Court is mindful of the importance of pretrial orders (See King v. Edward Co., 68 F. Supp. 1019 (1946)), and of plaintiff's objection to the consideration of issues beyond the terms thereof. However, without overruling such objection, we nevertheless state our conclusions on the merits of the issue of indefiniteness of price because it is in the plaintiff's favor.[25]
>
> "The option price to plaintiff is clearly stated in the contract (Par. 10) to be, as to plywood, the 'market price to jobbers' less 5% and an additional 2% for cash. The term 'market price to jobbers' is clearly defined and explained by example, in the contract. (See Definition (d)).
>
> "The option price, as to veneer, is likewise stated in Par. 10 to be the 'market price' less 5% and an additional 2% for cash." (R 80)
>
> "The Court is convinced, therefore, that under the terms of the contract and its practical interpretation by both parties, the option price for douglas fir plywood, the type of plywood in which the parties were dealing, was simply the 'market price' thereof to jobbers, less a further 5% and 2% discount to plaintiff—without reference to the so-called five plant formula set up for the contemplated, but never realized, manufacture of 'digger pine' plywood.
>
> "Even if we assume that the so-called five plant formula can be construed as applicable to plywood

25. In his second opinion, the trial judge held that the pretrial order was "sufficient" to present the issue (R 117). He did not amend the order.

other than 'digger pine' plywood, i.e., to fir plywood, we are of the opinion that such formula, considered in its relationship to the contract as a whole, was subordinate to the clear provisions of the contract (Par. 10; Definition (d); Par. 3, lines 3-4) that the option price was to be the market price to jobbers (which included a 5% functional discount) less a further 5% and 2%.

"That the five plant formula should be regarded as a mere guide or indication of such market price is clear. Apart from the improbability that parties would make a contemplated 5-10 year contract wholly dependent on the continued existence and price quotation of five particular plants, there is the significant circumstance, shown by the evidence, that, although one of the named mills was not publishing prices at the specified plant, and although the other four were either soon out of business or not publishing, the subject of a possible failure of price formula was never raised or discussed by the parties during five years of daily operations under their contract.

"In any event, there is no evidence whatsoever to support defendant's theory that the parties abandoned their contract early during their operations to deal on a day to day negotiation of the price of plywood. Neither party ever gave any such indication during nearly five years—until defendant attempted to repudiate the contract in November, 1960." (R 82-83; emphasis in the original)

On September 4, 1962 the court entered an order allowing a partial new trial limited to

"* * * the issue of breach and damages re so-called 'outside' sales, and as to the issue of damages resulting from any and all breaches or repudiation of the contract in question;" (R 89)

It denied defendant's motion for a new trial

> "* * * upon the issue of the validity and enforceability of the contract;" (R 89)

Plaintiff suggested that the question whether the five-mill formula was intended to apply to douglas fir plywood was material to the computation of its damages (R 96, 96A).

The partial new trial on these limited issues commenced on December 3, 1962. At the conclusion of the testimony, the trial judge announced that plaintiff had introduced evidence at the retrial respecting "the circumstances under which the contract was made", and he would therefore "have to" reconsider the excluded issue of its "certainty and validity" (2 Tr 708). This testimony was merely that (contrary to the judge's first opinion) the parties intended the five-mill formula to apply to douglas fir plywood (R 98-99).[26]

On January 31, 1963 the trial judge issued a memorandum of opinion (R 98) holding that

(a) The parties had for five years "waived" the five-mill formula and thereby "modified" the contract. Executory effect could not be given to the "waiver" under § 1698 of the California Civil Code.[27]

26. It did not, of course, relate at all to the alternative ground of the first decision, namely, that the formula was a subsidiary term of the contract.
27. "§ 1698. Written or Oral.—A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise."

(b) Despite his prior contrary finding (R 82-83), the five-mill formula was an "essential" term of the contract, and although the parties had performed the contract for five years without using it, their inability to apply it literally prevented any executory enforcement of the contract.

The issue which the trial judge treated as dispositive of the claim for lost future profits was not asserted in the answer (R 13) or the pretrial order which superseded the pleadings (R 28).[28]

(c) Defendant's outside sales did not constitute a breach of contract.

The court refused to rule on the question of damages.[29]

---

28. Defendant's contentions in the pretrial order were:

"I.

"Defendant contends that said contract was, if any contract ever existed, abandoned and repudiated by the parties thereto immediately after its formation, and that this action is therefore barred by Section 337 of the Code of Civil Procedure of the State of California.

"II.

"Defendant contends that the purported contract involved is so indefinite and uncertain in its terms as to the amount of veneer or plywood plaintiff is or was required to supply orders to the defendant for, that it is not susceptible to specific performance or that upon its breach or repudiation by defendant that damages may not be awarded against defendant and in favor of plaintiff.

"III.

"Defendant contends that the purported contract involved did not nor does it now bind plaintiff to supply any orders on veneer or plywood, but said purported agreement leaves the supplying of said order to the will, want, wish or desire of plaintiff so that the purported agreement lacks mutuality of risk of obligation and remedy barring relief to plaintiffs [sic] against defendant by way of specific performance and/or damages in any sum or at all." (R 31-32)

29. The opinion stated that it would not do so except on plaintiff's application (R 122). Plaintiff made no application, but resisted defendant's improper proposed finding, which completely disregarded the trial court's opinion, that there was no damage (R 158, 160, see 125, 144).

B.

The memorandum of opinion of January 31, 1963 recites that the court's prior memorandum of decision of August 14, 1962 (on the motion for a new trial)

> "* * * is hereby referred to and made a part of this Memorandum except as it may be modified or supplemented herein." (R 98)

Defendant, as requested by the court (R 122), filed proposed findings and conclusions which were inconsistent with the court's opinion in critical respects[30] and in which findings and conclusions were improperly labeled and indiscriminately mixed together (R 150). Plaintiff filed a notice of its disapproval and formal objections to the court's memorandum of opinion and moved for reconsideration of the decision. It also filed objections to defendant's proposed findings and conclusions (R 123, 125, 136, 144).

On March 21, 1963 the court signed findings and conclusions and entered judgment in the form tendered

30. Three examples should be sufficient: (1) Proposed Findings VIII and XI and Conclusions IV and V (R 153, 154-156, 158-159) provided that the contract price was to be fixed under the five-mill formula, which was the "sole means" of doing so. The trial court's opinion, however, expressly and repeatedly held that the contract called for sales at the market price and that the formula was a contingent standard intended to be used only when market price could not otherwise be determined (R 82-83, 102, 110, 119-120); (2) Proposed Finding XIX and Conclusion X (R 158, 160) simply disregarded the court's ruling that it need not and would not decide the issue of damages (R 122) and purported to decide the question in defendant's favor; (3) Proposed Finding X respecting day-to-day dealings (R 154) was an attempt to preserve a theory of contract abandonment which the trial court expressly rejected in both of its opinions (R 83, 106-108).

by defendant (see R 160, 161) and entered a further order stating:

> "The Court adopts as its Findings of Fact and Conclusions of Law its memorandum opinion of February 1, 1963, as supplemented by the Findings of Fact and Conclusions of Law signed March 20, 1963, insofar as the latter are not inconsistent with the former. * * *" (R 149)

QUESTIONS PRESENTED

1. The Nature of the Contract

Was the contract a simple option to buy personal property, as the trial court held, or was it an exclusive sales distributorship agreement?

2. Executory Enforcement

a. Did the fact that the five-mill formula could not be literally applied to transactions between the parties render the entire contract incapable of executory enforcement?

b. Was the five-mill formula an essential term of the contract?

c. Did the parties make a practical construction of the contract, i. e., that the five-mill formula was only a subsidiary guide or barometer to market price, as distinguished from "waiving" the formula or "modifying" the contract with respect to it?

3. Outside Sales

Did defendant's outside sales to plaintiff's customers and others prior to repudiating the contract breach its implied obligations under the contract?

4. Procedure

a. Was the ground on which the trial court held that the contract was incapable of executory enforcement available to defendant under the pleadings, the pretrial order and the order for a partial retrial?

b. Did the trial court err in reversing its prior holding that the contract was valid and enforceable on the basis of evidence offered and received at the partial retrial on other issues and after expressly refusing to allow that question to be retried at all?

SPECIFICATIONS OF ERROR[31]

1. The trial court erred in finding or concluding that the contract created the relationship of optionee-buyer and optionor-seller, as distinguished from selling principal and sales agent, that it was drawn to avoid the latter relationship, and that it had none of the characteristics of an agency and all of the characteristics of a buyer and seller relationship (1 Op, R 78, 86-87; 2 Op, R 121-122).

31. "1 Op" means the court's memorandum of decision dated August 14, 1962; "2 Op" means its memorandum of opinion dated January 31, 1963. "Find" and "Concl" refer to the findings and conclusions prepared by defendant's counsel and adopted by the court "insofar as * * * [they] * * * are not inconsistent with" the second opinion (R 149).

The contract and the evidence established as a matter of law that this was an exclusive sales distributorship agreement, which contained elements of both sale and agency and imposed obligations on the parties peculiar to both relationships. The finding is clearly erroneous, and the conclusion is contrary to law.

2. The trial court erred in reversing its prior finding or conclusion that the five-mill formula was a subordinate contract provision which was subject to paragraph 10 of the contract, which provided that the option price was the market price to jobbers less 5%, 2%, and in holding that its said prior finding was only dictum in its first opinion (2 Op, R 99).

The contract and the evidence established as a matter of law that the prior finding was correct. The court's action was clearly erroneous and contrary to law.

3. The trial court erred in concluding that the five-mill formula was "comparable" to a sale at a valuation within the meaning of § 1730 of the California Civil Code (2 Op, R 100-101).

Under the contract, the formula was not dependent upon anybody's discretion or judgment but related only to an objective standard and § 1730 of the Code had no application as a matter of law. The conclusion is contrary to law.

4. The trial court erred in finding that market price

is difficult, if not impossible, to determine in the plywood industry, and that the parties encountered great difficulty in performing the contract in the absence of the five-mill formula, because market price in general was not readily ascertainable under the conditions of their industry (2 Op, R 105, 115; Find XI, R 154).

The evidence established that the parties, individually and together, could and did determine market price consistently and without substantial difficulty for more than five years. The finding is clearly erroneous.

5. The trial court erred in finding that the parties anticipated that in the absence of the five-mill formula market price would be impossible or extremely difficult to ascertain (2 Op, R 111; Find XI, R 154).

There was no evidence to support the finding, which is clearly erroneous.

6. The trial court erred in finding or concluding that the five-mill formula was intended to be a definitive and binding provision for determining market price in those cases where the parties could not otherwise determine it (2 Op, R 110-111, 119-120); that to the extent that the parties could not otherwise determine the market price from available market information it was indispensable to the contract (2 Op, R 113); and that resort to it or insistence upon it at any time by either party would have left the parties without any enforceable contract at all (2 Op, R 115, 120).

The contract and the evidence established that the formula was no more than a guide to aid the parties in determining market price under the contract, that it was not essential to the contract, and that it did not have the meaning or legal effect given it by the trial court. The findings are clearly erroneous and the conclusions are contrary to law.

7. The trial court erred in finding or concluding that the parties impliedly agreed from time to time to disregard and waive the five-mill formula, and that the contract was modified as to executed transactions by their said mutual waiver and consent (2 Op, R 107-108, 114-115; Finds XII, XVI, R 156, 157).

The terms of the contract and the undisputed evidence established that the parties performed the contract without referring to the formula, as distinguished from "modifying" it or "waiving" its terms. The finding is clearly erroneous and the conclusion is contrary to law.

8. The trial court erred in finding or concluding that the price provisions of the contract were not ambiguous to the parties and that the doctrine of practical construction therefore could have no application to the case (2 Op, R 109, 110).

Paragraphs 3 and 10 of the contract were highly ambiguous, and the court so treated them in both of its opinions. This ambiguity rendered the doctrine of prac-

tical construction applicable to the case. The finding is clearly erroneous and the conclusion is contrary to law.

9. The trial court erred in finding or concluding that the parties did not make a practical construction of the contract as providing that the five-mill formula was merely a guide to assist them in determining market price and not a pricing standard (2 Op, R 112-113).

The contract and the evidence established that the parties did so. The finding is clearly erroneous and the conclusion is contrary to law.

10. The trial court erred in holding that plaintiff claimed the five-mill formula was not intended to be "binding" or "purposeful", and in concluding that it could apply the doctrine of practical construction only if it found that the formula was not intended by the parties to be "binding" or "purposeful" (2 Op, R 109, 112-114, 116).

Plaintiff made no such claims, and as a matter of law no such intent need be established; the conclusion is contrary to law.

11. The trial court erred in finding or concluding that the inference that the parties made a practical construction of the contract would be contrary to its clear terms and evidence of discussions at the time of its execution (2 Op, R 113) or that it would eliminate a clearly

stated, important and purposeful provision of the contract (2 Op, R 114).

The contract and the evidence established that the parties made a practical construction of the contract. The finding is clearly erroneous, and the conclusion is contrary to law.

12. The trial court erred in finding or concluding that once defendant withdrew its implied consent, further dealings on a general market price basis became quite impractical and, except for constant litigation to resolve disagreements on market price, impossible (2 Op, R 116).

The evidence established that there was in fact no such "implied consent," nor was it ever "withdrawn"; market price never was or became incapable of ascertainment, and the matter, in case of disagreement, was subject to arbitration under the contract. The finding is clearly erroneous and the conclusion is contrary to law. It is also inconsistent with the court's repeated finding that the parties intended to deal at the general market price.

13. The trial court erred in finding or concluding that defendant "elected" to stand upon the contract as written and assert nonenforceability because of the failure of the five-mill formula and was entitled to do so (2 Op, R 116, 120; Find XVI, R 157).

There was no evidence whatever to support the finding, and it was clearly erroneous. Defendant never sought to apply the formula or require its application to any transaction, nor did it ever resort to the arbitration clause of the contract. The conclusion is contrary to law.

14. The trial court erred in concluding that plaintiff had the burden of proof of the proper construction of the contract as shown by the conduct of the parties and in failing to hold that defendant had the burden of proof of facts establishing any asserted discharge of the contract by impossibility or frustration (2 Op, R 117).

The isssue of impossibility or frustration of the contract was a matter of defense to be pleaded and proved by defendant, which did neither; nor did defendant assert it in the pretrial order. The conclusion is contrary to law.

15. The trial court erred and acted arbitrarily and abused its discretion in setting aside the limitation in the order granting a partial new trial concerning the issues to be retried (2 Op, R 117; Concl II, R 158).

16. The trial court erred and acted arbitrarily and abused its discretion in holding that neither party had been deprived of a full opportunity to present all available evidence on all of the issues (2 Op, R 117).

17. The trial court erred and acted arbitrarily and abused its discretion in holding that the pretrial order

sufficiently presented the issue of the meaning and effect of the contract as it related to the five-mill formula (2 Op, R 117).

18. The trial court erred in finding that plaintiff at all times knew the amount of defendant's production, and that defendant never misled plaintiff or withheld information concerning the amount of plywood being produced, and that plaintiff knew that any unordered production was being sold by defendant to others (2 Op, R 118, 119; Find XIV, R 156).

The evidence established that plaintiff did not know about the outside sales, particularly the great bulk of them being made to its own customers, and that defendant concealed them from plaintiff. The finding is clearly erroneous.

19. The trial court erred in finding or concluding that defendant had an unqualified and unrestricted right to sell any portion of its production which plaintiff could not take during any month on the open market through other brokers or through its own sales organization (2 Op, R 118; Find II, XV, R 151, 156).

Defendant's right, as a matter of fact and law, did not extend to outside sales made by defendant's sales organization operating without advising plaintiff and soliciting plaintiff's customers in competition with plaintiff. Such conduct subverted the contract and

breached defendant's obligations thereunder. The finding is clearly erroneous, and the conclusion is contrary to law.

20. The trial court erred in finding or concluding that defendant was not obligated under the contract to refer prospective buyers to plaintiff before making outside sales, including those who were known by it to be plaintiff's customers (2 Op, R 120).

Such obligation was necessarily implied under the contract and the relationship of the parties as a matter of law. The finding is clearly erroneous, and the conclusion is contrary to law.

21. The trial court erred in finding that plaintiff did not prove that defendant's quoted mill prices, at times when the parties could not agree on market price, were above the market price, and that defendant had offered evidence that its quoted prices were not above the market price at such times (2 Op, R 120; Find XVIII, R 157).

The evidence established that defendant regularly insisted on a price which was above the market price as defined and understood by the parties; that plaintiff complained of this to defendant; and that it prevented plaintiff from selling defendant's production. The finding was clearly erroneous.

22. The trial court erred in finding or concluding

that plaintiff under the contract could fill orders which defendant might refer to it from other mills, or that it may have done so under the name of Plywood Veneer Sales Co., and that defendant was therefore compelled to make outside sales without referring them to plaintiff in order to stay in business (2 Op, R 121).

The contract and the evidence established that plaintiff did not do so, and that such acts would have breached its duties under the contract. The finding is clearly erroneous, and the conclusion is contrary to law. No such charge was made by defendant.

23. The trial court erred in finding that defendant did not deceive plaintiff with respect to the volume of its sales to United States Plywood Corporation (2 Op, R 121).

The evidence established that defendant did so, and that it failed to furnish plaintiff with information about those sales, as it had promised. The finding is clearly erroneous.

24. The trial court erred in finding or concluding that the implied obligations of good faith and fair dealing contained in all contracts, including exclusive distributorship agreements, were not applicable to the relationship created by this contract (2 Op, R 121-122) and that there was no evidence of a breach by defendant of such implied obligations (2 Op, R 122; Find XVI, R 157).

This was not a proper finding; the contract and the evidence established as a matter of law that this was an exclusive distributorship agreement which placed defendant under such implied obligations. The finding is clearly erroneous, and the conclusion is contrary to law.

25. The trial court erred in finding that defendant's repudiation of the contract and refusal to accept further orders did not constitute a breach of contract (Find V, R 152).

This is not a proper finding; it is contrary to the evidence and the law and is clearly erroneous.

26. The trial court erred in finding and concluding that the parties intended and that the agreement provided that the option price plaintiff was to pay defendant for plywood was to be fixed by a determination of market price under the provisions of the five-mill formula in paragraph 3 and that the five-mill formula was the manner by which the parties agreed to fix price and constituted an outside or objective means of determining market price, and that it was intended by the parties, at the time said agreement was executed, to be the sole and objective binding means of fixing price under the agreement (Find VIII, R 153; Concls IV, V, R 158, 159).

This is not a proper finding; it is contrary to the

express holding of the trial court in its second opinion and Finding IX and was contained in findings which were adopted by the trial judge only insofar as they did not conflict with the second opinion; it is clearly erroneous, and the conclusions are contrary to law.

27. The trial court erred in finding that the failure of the five-mill formula left the parties without any means of determining market price binding on either or both and that thereafter there was no obligation upon plaintiff to buy and none upon defendant to sell at a price that was not mutually acceptable, and the parties so construed their day-to-day dealings (Find X, R 154).

This is not a proper finding; it is contrary to the express holding of the trial court in its second opinion and was contained in findings which were adopted by the trial judge only insofar as they did not conflict with the second opinion; it is clearly erroneous and is merely an effort to preserve defendant's theory of abandonment which the trial court expressly rejected.

28. The trial court erred in finding that the parties made a "subjective evaluation" of market price from other sources (Find XI, R 154).

The evidence established that the parties determined market price by reference to external, objective sources. The finding is clearly erroneous and is immaterial to any issue in the case.

29. The trial court erred in finding that in view of the unworkability of the five-mill formula, the parties had no objective standard of price determination whereby a binding price could be dictated in those cases where they could not agree on the current market price (Find XI, R 154).

This is not a proper finding; it is immaterial to any issue in the case, because no such standard was essential to the validity and enforceability of the contract. The finding is clearly erroneous, because the market price established a workable objective standard.

30. The trial court erred in finding that the five-mill formula was not a mere guide for fixing price, but constituted an essential provision of the written contract (Find XI, R 156).

This is not a proper finding. The contract and the evidence established that it was a mere contingent guide to the market price and was not an essential or important provision of the contract. It is clearly erroneous.

31. The trial court erred in finding that defendant's repudiation of the contract was not in violation of the contract, because the contract had already become unenforceable as to executory portions thereof by reason of the failure of the "price fixing formula" (Find XIII, R 156; see R 117).

This is not a proper finding and is clearly erroneous.

32. The trial court erred in finding and concluding that defendant's outside sales did not violate the contract (Find XV, R 156; Concl VIII, R 159).

This is not a proper finding and is clearly erroneous and the conclusion is contrary to law. The outside sales constituted a flagrant breach of defendant's duties under the contract.

33. The trial court erred in finding that defendant performed any and all obligations and duties under the contract prior to its repudiation thereof and did not breach the contract during said period, because said contract became unenforceable as to the executory provisions thereof upon the failure of the price fixing formula (Find XVII, R 157).

This is not a proper finding and is clearly erroneous.

34. The trial court erred in entering a formal finding and conclusion tendered by defendant that plaintiff had not been damaged by defendant's acts (Find XIX, R 158; Concl X, R 160).

This finding and conclusion are contrary to the terms of the trial court's second opinion and were contained in findings which were adopted by the trial judge only insofar as they did not conflict with the second opinion; the finding is clearly erroneous and the conclusion is contrary to law.

35. The trial court erred in concluding that shortly

after its execution, the contract became unenforceable because of the failure of the five-mill formula, thereby rendering it uncertain and indefinite in one of its essential terms (Concl VI, R 159; see also R 117).

This conclusion is contrary to the evidence and the law, which established that the five-mill formula was not an essential term of the contract and the contract did not become uncertain or indefinite, either in fact or in law.

36. The trial court erred in concluding that the contract was modified by the parties as to executed transactions by mutually disregarding the five-mill formula in cases where they agreed on market price; that their conduct amounted to a mutual waiver of the formula as to executed transactions only; and that said modification was ineffective as to executory portions of the contract under § 1698 of the California Civil Code (Concl VII, R 159).

This conclusion was contrary to the undisputed evidence and the law, which established that the parties performed the contract, without modification (until defendant wrongfully repudiated it), and did not waive any of its terms. Furthermore, the issue had not been tendered by the pretrial order and was excluded from the retrial.

37. The trial court erred in concluding that plain-

tiff had not sustained its burden of proving an enforceable contract (Concl IX, R 159).

This conclusion was contrary to the undisputed evidence and the law, which required that defendant plead and prove defenses of frustration or impossibility.

38. The trial court erred and acted arbitrarily and abused its discretion in adopting its second opinion, which included by reference its prior inconsistent opinion, as its findings and conclusions, as supplemented by findings and conclusions prepared and tendered by defendant, except insofar as the latter were not inconsistent with its opinion (R 149).

39. The trial court erred in failing to find that defendant breached the contract, causing plaintiff heavy damage; and in failing to determine and enter judgment for the amount of damages sustained by plaintiff.

SUMMARY OF ARGUMENT

1. The trial court erroneously concluded that the contract was merely an option for the purchase and sale of personal property, rather than an exclusive sales distributorship agreement. As a matter of fact and law, this was an integrated plant development and exclusive market representation program in which plaintiff carried the plant investment and the credit risk in the field, while defendant, which had the desire but not the ability to enter the plywood business, furnished the product to be sold.

2. This patent and serious error led to two others:

a. Contract provisions relating to the price of the goods assumed excessive importance. Thus, the trial judge erroneously held that even though the contract was one for sales at market price, the contingent five-mill formula which was designed to resolve differences about that price was "essential" to the contract, and when it could not be literally applied the entire agreement became incapable of executory enforcement.

The judge failed to recognize that in such agreements, pricing provisions, as between the parties, are subsidiary, because the price is being passed on to the "buyer's" customer and is primarily a measure of the "buyer's" commission. Moreover, use of the formula could not result in sales at prices higher than the general market price which the record shows the parties could and did ascertain in performing the contract. The parties paid no attention to the formula, and its asserted failure could not and did not discharge the contract.

b. The trial judge erroneously rejected plaintiff's contention that the parties were subject to mutual implied obligations of good faith and fair dealing contained in all contracts and which are essential to the operation of a sales distributorship agreement. Defendant's solicitation of a large volume of undisclosed direct outside sales at reduced prices to third persons, includ-

ing plaintiff's customers, during the life of the contract was a flagrant and deliberate breach of these duties.

3. The trial court incorrectly held that the contract was not capable of executory enforcement, because the parties orally "waived" the "essential" five-mill formula, thereby "modifying" the contract as to executed transactions only. In fact, the parties, who totally ignored it, made a practical construction of the contract by which the five-mill formula was no more than a guide to be used, if possible, to assist them in cases when they could not otherwise determine the general market price at which they dealt. This was an application and construction of the contract, not a waiver or modification of its terms, and in fact no one ever "insisted on" or even referred to the formula.

4. The record, as well as the contract itself, established that the five-mill formula was not an essential term of the contract, but was only an alternative guide to assist the parties in determining the market price.

5. Defendant's outside sales constituted a flagrant breach of its implied contractual obligations which were essential to the operation of the contract and amounted to a successfully executed plan to destroy the contract and deprive plaintiff of its benefits.

6. The trial judge's findings, by reason of the cross references to and from the first opinion, the second

opinion, the inconsistent findings prepared by defendant and signed by the court, and their conditional adoption by the trial judge in his order of March 21, 1963 constituted a prejudicial disregard of orderly judicial procedures and created serious confusion in the record of the case. Moreover, the trial court acted improperly and prejudicially in basing its decision on the asserted failure of the five-mill formula. This issue was not raised in the pretrial order; it was, however, resolved by the trial judge in plaintiff's favor in his first opinion and was specifically excluded from the issues to be retried; the trial judge reversed his prior ruling solely on the basis of evidence offered during the retrial on other issues which did not relate to grounds on which his first ruling had been based. The procedure was arbitrary and unreasonable.

7. The case should be remanded with instructions to compute and enter judgment for the amount of plaintiff's damages.

ARGUMENT

Introduction

The trial court concluded that the parties' performance of the contract for five years without reference to the five-mill formula, which had been incapable of literal application from the outset, constituted an oral "waiver" and "modification" of one of its essential terms. Since the "waiver" and "modification" could

not be given executory enforcement under § 1698 of the California Civil Code, the entire contract was subject to repudiation by defendant, because it was unworkable without the formula.

The following facts, which the court found, were apparently not thought to bear upon this unjust result:

1. In its first opinion of August 14, 1962 the trial court found that

a. The five-mill formula was a mere guide or indication of the general market price, which was the option price and was subordinate to the market price provisions of paragraph 10 (1 Op, R 82-83);[32] and

b. An option to buy at market price to jobbers less 5%, 5%, 2% is not indefinite or inadequate as an objective standard for pricing, and such market price is legally ascertainable (1 Op, R 84).[33]

2. In its second opinion of January 31, 1963 the trial court correctly found and concluded that

a. The parties intended that sales should be made at the current market price. The five-mill formula was to have no application except when they could not otherwise determine it (2 Op, R 102, 110, 119-120).

b. During nearly five years of daily operation under

32. This holding was reversed in the second opinion.
33. The trial judge did not hold in his second opinion that market price is not legally ascertainable, but only that it is "difficult" to determine (see R 105). He also held that a contract for sales at market price is legally effective (R 107).

the contract before any controversy arose, under industry conditions and practices presumably known to the parties since the execution of the contract, neither party ever referred to the five-mill formula or its asserted unworkability, or to the effect of such "unworkability" upon the contract, or ever sought to apply the formula, and the parties at all times proceeded to ascertain market price by reference to general market information (2 Op, R 102-103, 107, 115; Find XI, R 154-156).

c. The original contract was never abandoned, nor was any substituted arrangement entered into; on the contrary, the parties acted under it at all times prior to its repudiation by defendant.[34] During this period, plaintiff renewed the contract, and the parties negotiated for its termination, all without any suggestion that it was not operating successfully. The failure "from time to time" to agree on the market price

> "* * * did not arise from bargaining for a new, mutually agreeable price under a new day to day arrangement, i.e., under a new substituted oral contract, but only from an inability of the parties to agree upon what the 'market price' for plywood happened to be at particular times." (2 Op, R 106-107)

d. Under the contract (Par 10) the parties dealt at general market price (2 Op, R 102, 110, 119-120), but

34. This confirmed its holding in the first opinion (1 Op, R 83).

defendant insisted that prices be quoted near the top of the market spread (2 Op, R 104).[35]

e. When the parties could not agree upon the market price, plaintiff refrained from exercising its option (2 Op, R 105; Find XI, R 154-156).

The court's conclusion also ignored the business context in which the parties operated. The "price" was largely a matter of indifference to plaintiff, except as it might promote or hinder sales, because plaintiff did not buy for its own warehousing or use but only for a specific resale to an identified customer at a predetermined price. The price was, of course, important to defendant. However, defendant's true concern, as shown by the evidence, was to determine the highest price at which the plywood could be sold, and that price was determined by the general market, not by the parties. In this situation, the formula could not possibly be anything more than a guide to the market price at which the parties had to and did operate.[36]

While the formula might assist to resolve an occasional difference of opinion over market price, it could never increase that price to defendant's benefit. It could only produce sales if it resulted in a price equal to or less than the actual market price at any particular

35. The evidence was undisputed that this lost the parties many sales, since prospective customers could always get a lower price elsewhere.

36. That this was its function is shown by the testimony of both parties that the named mills were selected because they were, by reason of their location and production, those closest and most similar to defendant's mill.

time. It could be computed only at irregular intervals (see par 3) and would not reflect current changes in the market. It is therefore not surprising that the parties ignored it altogether.

I.

The contract was not a mere option to purchase personal property, but was an exclusive sales distributorship agreement.

1. The trial court erroneously construed the written contract to be a mere option for the purchase and sale of personal property.

Sales distributorship agreements are frequently drawn in the form of contracts of purchase and sale.[37] This, however, does not adequately define such contracts or their consequences.

In *Mantell v. International Plastic Harmonica Corp.*, (1947) 141 NJ Eq 379, 55 Atl 2d 250 the court considered a sales contract for the distribution of a new product which provided that the price should be no higher than that charged any other distributor. No other distributor was ever appointed. The defendant-manufacturer made sales in plaintiff's territory, contending that the contract had failed, because the contract price could not be determined. The court rejected this contention, saying:

37. The usual retail franchise is nearly always of this kind. There are, of course, alternative forms such as agreements of consignment, brokerage and factorage.

"This type of contract is a comparatively recent device to meet modern needs in the marketing and distribution of goods on a nationwide or regional scale. In the very nature of the exclusive sales and distribution contract, it is not usually practicable to fix prices and the quantum of goods sold; and the rules of certainty and definiteness which govern the ordinary contract of sale have no application. Unlike a pure contract of purchase and sale, agreements of this class embody mutual promises and obligations with sufficiently definite standards by which performance can be tested. The grant of the exclusive franchise is a consideration for the grantee's obligation to establish and develop a marker [sic] for the sale and distribution of the product in the area covered by the monopoly. The character of the contractual arrangement is such as to preclude explicitness as to quantity and prices. This is especially so where, as here, the product is new and untried and its potential worth and market value and the cost of manufacture and distribution are unknown quantities. Such contracts have the requisite mutual assent and consideration. They are not comparable to the ordinary executory agreement to buy and sell goods. * * *

* * * * *

"Contracts of this category are to be given a practical interpretation that will effectuate and not defeat the common intention in an area of conventional action that, due to unpredictable market conditions, production factors, and so on, ordinarily does not permit of great certainty and definiteness in the particulars mentioned." (55 Atl 2d 250 at 256-257)[38]

38. See also *Bendix Home Appliances, Inc. v. Radio Accessories Co.*, (CCA 8 1942) 129 F2d 177 at 181; *Marrinan Medical Supply, Inc. v. Ft. Dodge Serum Co.*, (CCA 8 1931) 47 F2d 458 at 460-461; *Ken-Rad Corporation v. R. C. Bohannan, Inc.*, (CCA 6 1935) 80 F2d 251 at 253; *Champion Spark Plug Co. v. Automobile Sundries Co.*, (CCA 2 1921) 273 Fed 74 at 80; *Stone v. Krylon, Inc.*, (DC ED Pa 1956) 141 F Supp 785.

This is the law of California. In *J. C. Millett Co. v. Park & Tilford Distillers Corp.*, (DC ND Cal 1954) 123 F Supp 484 at 492 the court defined the obligations of the parties on termination of a distributorship agreement under both sales and agency principles (at 492-493), saying:

> "The distributorship contract in the case at bar is more than a contract of employment or agency. It is also a contract of sale. On the other hand, it is more than a mere sales contract. It partakes of the substantial aspects of both."[39]

2. The present agreement (under which plaintiff was granted an "exclusive option" for 95% of defendant's production) was one for an exclusive distributorship. It pre-empted nearly all of defendant's output, subject only to paragraph 6, which permitted sales by defendant, directly or through brokers, of excess production subordinate to the option.[40] Plaintiff made substantial loans to defendant for its mill and to support its operation (Exh 49). The reservation by defendant of 5% of its production for local sales could not support other representation; nor was there any dependable "excess" production which could do so (Exh 17, pp 2-3). The contract was clearly stated to be and was one for exclusive sales representation, and any other construction

39. See also *Hunt Foods, Inc., v. Phillips*, (CA 9 1957) 248 F2d 23 at 28-29 (agency principles applied to determine termination rights); *Caspary v. Moore*, (1937) 21 Cal App 2d 694, 70 P2d 224 at 226; *San Francisco Brewing Corporation v. Bowman*, (1959) 52 Cal 2d 607, 343 P2d 1 at 5-6; *Kelly-Springfield Tire Co. v. Bobo*, (CCA 9 1925) 4 F2d 71 at 72.

40. One of defendant's complaints was that it could not make firm or continuing arrangements with others, because they would conflict with plaintiff's option (Schwab Dep 16).

would utterly disregard and destroy its essential purposes.[41]

II.

The trial judge's failure to recognize the true nature of the contract led to a failure to recognize and enforce its essential obligations.

The trial judge erroneously held that the contract was a mere option. His failure to recognize its true nature as an exclusive distributorship agreement led to two other fundamental errors:

a. He failed to recognize and enforce implied obligations which characterize all contracts and which are critical to the operation of distributorship contracts, and which required defendant in this case to perform the contract honestly and in good faith and do nothing which would destroy the value of the contract to either party.[42]

These obligations did not rest on defendant alone. Plaintiff was also obligated by express[43] and implied[44]

---

41. Agreements for exclusive distribution were found by implication in *Rudd-Melikian, Inc. v. Merritt*, (CA 6 1960) 282 F2d 924 at 927-929; *White Co. v. W. P. Farley Co.*, (1927) 219 Ky 66, 292 SW 472; *Navy Gas & Supply Co. v. Schoech*, (1940) 105 Colo 374, 98 P2d 860 at 861-862; *Mantell v. International Plastic Harmonica Corp.*, supra, (1947) 141 NJ Eq 379, 55 Atl 2d 250 at 256.
42. See post 70.
43. Paragraph 3 provides:
"SECOND PARTY [plaintiff], so far as possible, agrees to provide the FIRST PARTY [defendant] with orders for 95% of the output of its veneer or plywood. * * *"
See also paragraph 5.
44. *American Distributing Co. v. Hayes Wheel Co.*, (DC ED Mich 1918) 250 Fed 109 at 115, rev'd on other grounds (CCA 6 1919) 257 Fed 881; *W. G. Taylor Co. v. Bannerman*, (1904) 120 Wisc 189, 97 NW 918 at 919.

terms of the contract to use its best efforts in good faith to sell 95% of defendant's production, to assume the resulting credit risks and to finance the acquisition and installation of new equipment. There is no suggestion that plaintiff did not perform these obligations completely and in good faith.

b. The trial judge placed unwarranted and literal emphasis[45] on the contingent pricing clause of paragraph 3 of the contract and erroneously held that the five-mill formula was "essential" to its operation. However, under the contract orders were placed only for plaintiff's customers who had previously agreed to pay prices quoted by the parties. Pricing clauses in such a contract are designed to set a competitive price to the ultimate, not the immediate customer, who is not a party to the contract and will therefore require that the quoted price meet competition in the open market. It follows that they are, as first found by the trial judge (R 82-83), subordinate provisions, not essential to the obligations of the contract.

In *Laveson v. Warner Mfg. Corp.*, (DC NJ 1953) 117 F Supp 124 plaintiffs were exclusive distributors of defendant's products under an agreement which obligated defendant to supply such quantities as plaintiffs should "from time to time require, at prices to be agreed

45. See *Mantell v. International Plastic Harmonica Corp.*, supra, (1947) 141 NJ Eq 379, 55 Atl 2d 250 at 255; *West Caldwell v. Caldwell*, (1958) 26 NJ 9, 138 Atl 2d 402 at 410.

upon." Defendants' motions for summary judgment or dismissal were denied. The court said:

> "* * * Exclusive sales agency contracts, such as the present, differ from ordinary sales contracts in many respects, so that the normal contract rule cannot be blindly applied thereto. There are these important differences, as to the element of price, between ordinary sales contracts and sales agency contracts. In ordinary sales contracts, the price is not passed on to a third party, but is ultimately borne by the purchaser and paid by him to the seller. Hence the fixing of this price is essential to the contract. It is the very point in which the parties are primarily interested. Not so in the case of a sales agency contract. For there, both the principal and the sales agent pass on the agency price, in question, to the third party purchaser, to be paid by him, plus the agent's commission, as the final purchase price. For this reason the agency price is not so crucial to the parties in the sales agency contract. Furthermore, what the parties to a sales agency contract are interested in, is not a good price on a single sale, as in the case of an ordinary sales contract, so much as in a substantial volume of sales, each of which will give a fair profit to both the parties to the sales agency contract. Again, both such parties realize, that to fix an unreasonably high price will lessen this major desideratum of a volume of sales. Finally, both parties to a sales agency contract realize that the agency price, which, as one element of the ultimate sales price, will help both the principal and his sales agent attain this desideratum of sales volume, cannot be determined at first, but only as the result of actual experience. For all these reasons, *the price element in a sales agency contract differs from such element in an ordinary sales contract, and is not of the essence in the former, as it is in the latter.*[46] Further, it cannot be finally fixed in a sales

46. See also *Mantell v. International Plastic Harmonica Corp.*, supra, (1947) 141 NJ Eq 379, 55 Atl 2d 250 at 256.

agency contract entered into at the very beginning of the sales agency. * * *" (at 125-126; emphasis supplied)

The court further noted that the controversy (as here)

"* * * apparently is not caused by any question of price. Warner is attempting to escape the binding force of an agreement which it entered into with the full intention of making a contract. Warner's attempted justification is the legal technicality that the provisions of the agreement as to price are too vague to permit the existence of a contract. Nevertheless, this allegedly 'vague' provision has been satisfactorily applied by the parties for a period of three years. It is the duty of the Court to effectuate the intentions of business men, not to block them, and that is the intent of the above provision of the Uniform Sales Act." (at 127)[47]

In *Willred Company v. Westmoreland Metal Mfg. Co.*, (DC ED Pa 1959) 200 F Supp 55 at 57 *Laveson* was followed by Judge Kilpatrick, who said:

"The defendant's first contention would have more force if the contract here was an ordinary contract for the sale of goods. However, as pointed out in Laveson v. Warner Mfg. Corp., * * *, there are important differences, particularly as to the element of price, between ordinary contracts of sale and sales agency, or distributorship, contracts. In the latter the parties are primarily interested not in what is to

47. See also *Los Angeles Coin-O-Matic Laundries v. Harow*, (1961) 15 Cal Rptr 693 at 697, 195 Cal App 2d 324 and *Patty v. Berryman*, (1950) 95 Cal App 2d 159, 212 P2d 937, distinguishing the position of a middleman-purchaser under California law.

be obtained in a single transaction but in a substantial volume of sales in the future with changing conditions to be met. I do not think that the contract in this case is so indefinite and uncertain as to be unenforceable as a matter of law. As a matter of fact there never was any dispute which could be attributed to any indefiniteness of terms between the parties, who apparently were perfectly able to conduct their business under it. The breach alleged is a breach of the exclusive feature as to which particular term there could be no question of indefiniteness."

III.

The parties made a practical construction of the contract as providing that the formula was no more than a guide to assist them in determining the market price to be quoted third persons. They did not "modify" the contract or "waive" the formula.

Under § 1698 of the California Civil Code,[48] an oral modification of a written agreement cannot be given executory effect.

In his second opinion, the trial judge rejected the contention that the parties had made a practical construction of the contract with respect to the five-mill formula and held that it had been waived (or the contract modified) for five years, but that when defendant insisted upon its application[49] the contract became un-

48. "§ 1698. *Written or Oral.* — A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise."
49. There was no evidence at all that defendant did so.

workable and could not be further performed (R 115-116). Section 1698 therefore prevented executory enforcement. The trial judge also held that before the doctrine of practical construction could apply under California law, plaintiff had to prove that the formula "was never intended to have any binding effect upon the parties" and even if the evidence "upon this issue of construction by conduct" were equally balanced, defendant would win (R 116-117). He held that paragraphs 3 and 10 of the contract were not ambiguous and that plaintiff sought, by a process of contract construction, to "eliminate" paragraph 3 as a "meaningful" provision.

The analysis was faulty. The question, under California law, is not whether the parties intended the five-mill formula to be "binding"; it is not whether they meant what they said, but what they meant, and their consistent conduct over a period of five years, in good times and bad and before any dispute arose, is the most convincing evidence of that intent. In view of the manner in which they performed the contract and the provisions of paragraph 10, the meaning and application of paragraph 3 was highly ambiguous. Their conduct, however, established what it meant to them—that it was no more than a contingent and alternative aid to determine market price. The parties understood, as the trial judge could not, its limited and subordinate

function. There is simply no evidence that they found the contract (as they understood it) impossible or difficult to perform or that they ever intended an inability to give the formula literal effect (which was constant throughout the life of the contract) to have any bearing at all on the enforceability of the option.

The trial judge first accepted this position. In his first opinion, he found:

> "Even if we assume that the so-called five plant formula can be construed as applicable to plywood other than 'digger pine' plywood, i.e., to fir plywood, we are of the opinion that such formula, considered in its relationship to the contract as a whole, was subordinate to the clear provisions of the contract (Par. 10; Definition (d); Par. 3, lines 3-4) that the option price was to be the market price to jobbers (which included a 5% functional discount) less a further 5% and 2%.
>
> "That the five plant formula should be regarded as a mere guide or indication of such market price is clear. Apart from the improbability that parties would make a contemplated 5-10 year contract wholly dependent on the continued existence and price quotation of five particular plants, there is the significant circumstance, shown by the evidence, that, although one of the named mills was not publishing prices at the specified plant, and although the other four were either soon out of business or not publishing, the subject of a possible failure of price formula was never raised or discussed by the parties during five years of daily operations under their contract." (R 82-83; emphasis in the original)

The harsh rule of § 1698 has been consistently qualified in cases where the ultimate question is whether the parties amended their contract or performed it according to their understanding of what it meant. In *Bohman v. Berg*, (1960) 54 Cal 2d 787, 8 Cal Rptr 441 at 446-447, 356 P2d 185, the meaning of an uncertain agreement for labor and materials was established from the parties' conduct in performing it before any controversy arose. The court said:

> "This rule is in accord with the cardinal rule of construction that when a contract is ambiguous or uncertain the practical construction placed upon it by the parties before any controversy arises as to its meaning affords one of the most reliable means of determining the intent of the parties. Jackson v. First Nat. Bank & Trust Co. of La Porte, supra, 57 N.E.2d 946, 947. As was said in Mitau v. Roddan, 149 Cal. 1, 14, 84 P. 145, 150, 6 L.R.A., N.S., 275: '* * * [I]n all cases where the terms of their contract, or the language they employ, raises a question of doubtful construction, and it appears that the parties themselves have practically interpreted their contract, the courts will follow that practical construction. It is to be assumed that parties to a contract best know what was meant by its terms, and are the least liable to be mistaken as to its intention; that each party is alert to his own interests, and to insistence on his rights, and that whatever is done by the parties contemporaneously with the execution of the contract is done under its terms as they understood and intended it should be. Parties are far less liable to have been mistaken as to the intention of their contract during the period while harmonious and practical construction reflects that intention, than they are when subsequent differences have impelled them to resort to law * * *. The law,

however, recognizes the practical construction of a contract as the best evidence of what was intended by its provisions.' * * *.

"When the parties perform without objection under a contract the terms of which appear to be indefinite, they have indicated that its terms were sufficiently certain so that they, at least, could perform it. The conduct of the plaintiff in constructing and installing the items enumerated in the agreement of April 19th indicates that in his mind the contract was not too indefinite to be performed. * * *"[50]

In *Crestview Cemetery Association v. Dieden*, (1960) 54 Cal 2d 744, 8 Cal Rptr 427, 356 P2d 171 the question was whether an attorney's contract for services contemplated that he should merely secure a zone change or was responsible for ultimate approval of a cemetery location. The court, looking to the conduct of the parties, held that it is not what the words of the agreement mean to the court, but what they mean to the parties which is controlling (at 176). Justice Peters said:

"Appellants correctly claim that this doctrine of practical construction can only be applied when the contract is ambiguous, and cannot be used when the contract is unambiguous. That is undoubtedly a correct general statement of the law. * * * But the question involved in such cases is ambiguous to whom? Words frequently mean different things to different people. *Here the contracting parties demonstrated by their actions that they knew what the*

50. The court cited both *Mantell* and *Laveson* with approval, saying: "* * * the protection of a binding contract is not afforded merely to common and ordinary projects * * *." (at 447)

words meant and were intended to mean. Thus, even if it be assumed that the words standing alone might mean one thing to the members of this court, where the parties have demonstrated by their actions and performance that to them the contract meant something quite different, the meaning and intent of the parties should be enforced. In such a situation the parties by their actions have created the 'ambiguity' required to bring the rule into operation. If this were not the rule the courts would be enforcing one contract when both parties have demonstrated that they meant and intended the contract to be quite different." (356 P2d at 177-178; emphasis supplied)

See also *Mitau v. Roddan*, (1906) 149 Cal 1, 84 Pac 145 at 150:

"* * * This was a practical construction placed upon the contract by the parties themselves, which renders it immaterial to consider what might be the literal construction of its terms. Parties to a contract have a right to place such an interpretation upon its terms as they see fit, even when such an interpretation is apparently contrary to the ordinary meaning of its provisions. * * *"

In *Universal Sales Corporation, Ltd. v. California Press Mfg. Co.*, (1942) 20 Cal 2d 751, 128 P2d 665 at 672 the court said:

"* * * Also applicable here is the familiar rule that when a contract is ambiguous, a construction given to it by the acts and conduct of the parties with knowledge of its terms, before any controversy has arisen as to its meaning, is entitled to great

> weight, and will, when reasonable, be adopted and enforced by the court. * * * The reason underlying the rule is that it is the duty of the court to give effect to the intention of the parties where it is not wholly at variance with the correct legal interpretation of the terms of the contract, and a practical construction placed by the parties upon the instrument is the best evidence of their intention. * * *"

In this case, there was no evidence that the parties waived the formula or modified the contract — the evidence showed only that they performed it according to their understanding of its terms.

Plaintiff's failure to enforce its option by litigation when there was difficulty in determining the market price is not inconsistent with the construction which the parties gave to their contract. The contract was one both parties had to live with cooperatively for many years. It required good faith and continuing mutual efforts on both sides, and the failure to exercise the option in these cases was well within plaintiff's rights. There were, therefore, compelling business reasons for plaintiff's policy. It is significant that neither the validity of the option nor the formula itself was ever, in the course of any of these disagreements, mentioned or referred to.

The parties did not "waive" the five-mill formula or "modify" the contract. They made a practical construction of the entire contract in light of their business

and its actual operation. The only "waiver" was by the plaintiff, who did not insist on its view of the market price when disagreements arose, but merely refrained from exercising its option.

The court's reliance on the burden of proof was also mistaken. The question of the meaning of the contract as shown by the conduct of the parties related only to its ultimate holding that the contract became impossible of performance or was frustrated when defendant repudiated it. These were defenses as to which defendant, not plaintiff, had the burden of proof. *Gold v. Salem Lutheran Home Association (etc.)*, (1960) 53 Cal 2d 289, 1 Cal Rptr 343, 347 P2d 687 (frustration); *Hensler v. City of Los Angeles*, (1954) 124 Cal App 2d 71, 268 P2d 12 at 21 (impossibility).

Furthermore, there was no issue with respect to whether the five-mill formula was intended to be "binding". The issue was what paragraph 3 meant to the parties, and the undisputed testimony and the evidence of their conduct for five years proved its meaning *to them*. The court erred in holding that plaintiff had failed to sustain a nonexistent burden of proof with respect to a nonexistent issue.

IV.

The five-mill formula was not an essential term of the contract, and the parties' inability to give it literal application did not discharge them from the duty of further performance.

The record showed conclusively that the formula was not an "essential" term of the contract.

1. The contract by its nature was one in which price clauses are of subsidiary importance, because its operation is basically controlled by the market (supra 55-58).

2. As a matter of contractual intent, it is inconceivable that the parties would have negotiated a ten-year marketing agreement dependent for its validity on the continued existence or operation of five named plywood mills, nor would plaintiff have committed itself to a large loan or made heavy additional advances during the life of the contract on such a basis. Their conduct showed that they did not do so. (See the trial judge's first opinion, R 82-83.)

It is undisputed that the parties dealt under the contract nearly every day for five years, and plaintiff sold three-fourths of defendant's total production during that period without either arbitration or litigation to determine the market price and without any reference whatever to the formula.

3. In denying appellant's claim for executory enforcement, the trial judge ignored the contract arbitration clause (paragraph 18), which required that

> "* * * any disagreement or difference * * * in relation to this contract either as to the construction or operation thereof, or to the respective rights and liabilities thereto, * * *"

shall be arbitrated under the provisions of the California arbitration statutes (§ § 1280-1293, Cal Code Civ Proc) (R 24-25).

The precise questions of the construction and meaning of the contract on which he relied in holding that the contract was "unworkable" without the formula were unquestionably subject to arbitration under the comprehensive terms of paragraph 18.[51] In addition, disputes over the market price itself were arbitrable; indeed, the contract expressly provided for the arbitration of veneer prices if necessary in order to make sales.[52] In *Shell Oil Company v. FPC*, (CA 3 1961) 292 F2d 149 the court recognized and held that in this situation an arbitration clause provides an agreed and

---

51. See *Posner v. Grunwald-Marx, Inc.*, (1961) 56 Cal 2d 169, 14 Cal Rptr 297, 363 P2d 313 (construction of "unambiguous" provision of collective bargaining agreement held arbitrable question); *Brink v. Allegro Builders, Inc.*, (1962) 58 Cal 2d 577, 25 Cal Rptr 556, 375 P2d 436; 6A Corbin on Contracts (1962) 463-464 (§ 1444A). Specifically, the question whether the formula was a mere alternative guide to market price was arbitrable.

52. Paragraph 10 provides: "In the event said veneer cannot be sold at the prices set forth on Exhibit 'A', the price shall be fixed by arbitration under paragraph 18 if the parties themselves cannot fix the market price."

effective alternative method of establishing a price if negotiations to determine it are unsuccessful.

The court correctly found that the contract price was the general market price and that this is an objective standard.[53] The contract itself shows that the parties contemplated the use of arbitration to determine the price and that it was within their contract that it should and could be determined in ways other than by the formula. The trial judge erred in ignoring the arbitration clause in the contract.

4. The trial judge held that the five-mill formula was essential to the contract, because it was to be used to resolve occasional disputes over the prevailing market price. The record showed that roughly 75% of defendant's production was marketed by plaintiff under the contract over a period of five years without reference to the formula, even though during a part of that time defendant was actively subverting the contract by soliciting and making direct outside sales. Plaintiff's failure to enforce its option when the parties disagreed, even if it had evidenced a recognition that such disagreement would prevent a transaction between them, could not, as a matter of law, make the formula an "essential" term whose failure justified defendant's repudiation of the entire contract. There was a continuing obligation to determine the market price in good faith. A right not

53. See *California Lettuce Growers, Inc. v. Union Sugar Company*, (1955) 45 Cal 2d 474, 289 P2d 785 at 790-791.

to deal in a specific case would not give a right of repudiation or a refusal to deal in all cases. In *Jay Dreher Corporation v. Delco Appliance Corporation*, (CCA 2 1937) 93 F2d 275 a distributorship agreement allowed the manufacturer to reject "any" order. The court held that this did not give it a right to terminate the contract. The court said:

> "* * * All that the clause meant was that he should have no recourse over for his loss in such a case; it was an excuse for non-performance to be exercised bona fide, not a privilege to repudiate. * * * the defendant will use an honest judgment in passing upon orders submitted, considering them on equal terms with others it may receive and weighing them against its available supply. * * *." (at 277)

This rule was applied in *Milton v. Hudson Sales Corporation*, (1957) 152 Cal App 2d 418, 313 P2d 936 in which, on similar facts, the *Dreher* case was followed, and the court held that a reservation of the right to reject specific orders did not entitle the manufacturer to terminate the contract.

> "* * * If the contract had contained a clear-cut statement that Hudson was to be under no duty at all to sell cars to Milton, and could, even in bad faith, and with intent to injure Milton, refuse to sell him cars, would any reasonable businessman have signed it? Of course, there is an implied covenant in all contracts that the parties will act in good faith. Hudson's interpretation would violate such a covenant. * * *" (at 942)

Defendant's contention that the contract was discharged and the court's finding that it had become unworkable amount only to the assertion that defendant could lawfully destroy it by refusing in bad faith to determine prevailing market prices, whereas the evidence is conclusive that the parties could and did determine it in the vast majority of cases when they attempted in good faith to do so.[54]

5. Finally, the record showed that any inability of the parties to determine market price was only occasional and was not such "impossibility" as would operate to discharge them from continued performance or do more than suspend defendant's duty to perform. See *Oosten v. Hay Haulers (etc.) Union*, (1956) 45 Cal 2d 784, 291 P2d 17 at 20.

V.

The outside sales constituted a breach of defendant's obligations under the contract.

1. Every contract includes implied obligations of good faith and honest dealing and duties to do nothing which will impair the contract, make it difficult or impossible to perform, or destroy its value to the other contracting party. See the classic statement of the rule by Cardozo, J., in *Wood v. Lucy, Lady Duff-Gordon*, (1917) 222 NY 88, 118 NE 214; see also California Civil Code, § § 1655, 1656.

54. See also *Sidella Export & Import Corp. v. Rosen*, (1948) 273 App Div 490, 78 NYS 2d 155 at 157 (implied duty to secure ruling on ceiling price).

In *Harm v. Frasher*, (1960) 181 Cal App 2d 405, 5 Cal Rptr 367 at 374 the court stated the rule as applied in California:

> "* * * There is implied in every contract a covenant by each party not to do anything which will deprive the other parties thereto of the benefits of the contract. * * * This covenant not only imposes upon each contracting party the duty to refrain from doing anything which would render performance of the contract impossible by any act of his own, but also the duty to do everything that the contract presupposes that he will do to accomplish its purpose. * * *"[55]

2. In distributorship contracts,[56] this places an obligation on the manufacturer not to operate in a way which unfairly competes with the distributor within the scope of the distributorship and destroys the value of the contract to him. Much of the value of the distributor's services lies in his market connections and the facilities which he can command. These are the basis of his service to the manufacturer. In the course of such a contract, however, much of this information and the market connections and facilities which the distributor uses for the manufacturer's benefit can become known to the manufacturer and, with a little effort, subject to

55. The rule is of constant application. See *Universal Sales Corporation, Ltd. v. California Press Mfg. Co.*, supra, (1942) 20 Cal 2d 751, 128 P2d 665 at 677; *Bewick v. Mecham*, (1945) 26 Cal 2d 92, 156 P2d 757 at 761; *Brown v. Superior Court (etc.)*, (1949) 34 Cal 2d 559, 212 P2d 878; *California Lettuce Growers, Inc. v. Union Sugar Company*, supra, (1955) 45 Cal 2d 474, 289 P2d 785 at 792.

56. The same rule applies to option contracts. *McFerran v. Heroux*, (1954) 44 Wash 2d 631, 269 P2d 815 at 819-820 and authorities there cited.

his direct use. The temptation may arise in such a case to seek and make direct sales which subvert and constitute a breach of the contract. The evidence proved that defendant engaged in just that type of program. Its direct sales constituted a deliberate and flagrant breach of contract.

Smyth Sales, Inc. v. Petroleum Heat & Power Co., Inc., (CCA 3 1942) 128 F2d 697 at 700-701 was an action for damages for deceit in which it was charged that the supplier invaded the distributor's territory. The court said:

> "Exclusive sales agreements have been variously construed as creating an agency or a buyer and seller relationship. In most of the cases found there was not the relation of principal and agent in the ordinary sense of that term but the grant by a distributor (who was a manufacturer or wholesaler) to a distributee (a wholesaler or retailer) of an exclusive right to sell products of the former. This is the situation in the case at bar. However, the resultant relationship is not totally devoid of attributes which the law imposes upon parties in the relation of principal and agent. In other words the duties of mutual trust, confidence and loyalty so far as the subject matter of their dealing are concerned are applied to the parties to an exclusive sales transaction. The parties are not, as ordinary vendor and vendee, dealing at arm's length. They have, of their own accord, agreed to conform to a peculiar but mutually advantageous arrangement. *We believe that this relationship requires full disclosure by the parties of all facts pertinent to the exclusive sales provision*, * * *" (Emphasis supplied)

See also *E. H. Taylor, Jr., & Sons v. Julius Levin Co.*, (CCA 6 1921) 274 Fed 275 at 282 as follows:

> "* * * In the present contract, as to its executory portions, the continuing dependence of each upon the integrity and faithfulness of the other necessarily subjects it to the same rules in the respect now under consideration as are applied to strict contracts of agency."

In *J. C. Millett Co. v. Distillers Distributing Corporation*, (CA 9 1958) 258 F2d 139 at 144 this Court held that under California law the principal breached a non-exclusive distributorship by contacting retailers and discouraging them from placing orders with the distributor, thereby assisting its competitors. The manufacturer had breached implied obligations of the contract not to engage in activities harmful to the distributor in selling the product (citing *Brown v. Superior Court (etc.)*, supra, (1949) 34 Cal 2d 559, 212 P2d 878).

In *A.R.A. Manufacturing Company v. Pierce*, (1959) 86 Ariz 136, 341 P2d 928 the manufacturer announced to persons who were or could be the plaintiff-distributor's customers that it would make direct sales to them at the same prices at which it sold to plaintiff. The court said (at 930):

> "* * * Whether it was or was not such an offer, an implicit promise of every exclusive distributorship agreement is that the manufacturer will do nothing to impair the efforts of the distributor to sell the manufacturer's product. * * * The corollary promise of the distributor party to such an agreement, established by Judge Cardozo's opinion in

> Wood v. Lucy, Lady Duff-Gordon, * * * of course, is that he will use his best efforts to promote the sale of the manufacturer's product. * * *
>
> " 'Business contracts,' we are reminded by the words of Mr. Justice Holmes, 'must be construed with business sense, as they naturally would be understood by intelligent men of affairs.' * * * Here, the business sense of the agreement was that appellant would rely on Arctic, and Arctic would undertake a corresponding obligation, to accomplish the efficient distribution of appellant's air conditioning units. That Arctic could not do if its customers were enticed or intrigued by the prospect of cheaper prices available elsewhere, * * * or if they were made explicitly aware that doing business with Arctic as an intermediary resulted in a higher market price than otherwise might prevail. * * *"

The "apparent tendency" of defendant's conduct to defeat the essential purpose of the parties "made it a material breach as a matter of law." See also *Buckley & Scott Utilities, Inc. v. Petroleum Heat & Power Co.*, (1943) 313 Mass 498, 48 NE 2d 154 at 157:

> "Moreover, even in the absence of an express agreement, there would have been implied in the franchise an agreement on the part of the 'owner' not to engage in competition with the 'dealer' in the latter's exclusive territory by means and in a manner that would practically destroy the right granted and that would also render it impossible for the 'dealer' to 'promote' sales and to 'operate his entire territory' as the terms of the franchise required it to do."[57]

57. See also: *Arcoil Co. v. Jacobson Manufacturing Co.*, (1929) 7 NJ Misc 1024, 147 Atl 739; *Milton v. Hudson Sales Corporation*, supra, (1957) 152 Cal App 2d 418, 313 P2d 936 at 942, 945-946.

Defendant's large volume of outside sales at discounts of 5%, 5%, 2% and more breached essential obligations of the contract. They were principally made to plaintiff's customers at prices which undercut those which plaintiff could offer and were accompanied by an insistence on a noncompetitive price level and a developing program of direct solicitation. They were not merely sales under paragraph 6 of the contract of excess production not sold by plaintiff. Defendant's undisclosed sales program itself created the inventory from which they were made—by preventing plaintiff from making sales and making them itself to plaintiff's customers at prices below those plaintiff could meet, but which still secured to defendant its anticipated net return.

Defendant cannot contend that plaintiff would not have made those sales. *Hacker Pipe & Supply Co. v. Chapman Valve Mfg. Co.*, (1936) 17 Cal App 2d 265, 61 P2d 944 was an action by an exclusive dealer complaining of direct sales made by the supplier in his territory. The defendant contended that the sales were proper and had not damaged the plaintiff, because they were made at the prices which were offered plaintiff. The court, however, held:

> "The fact that the goods were sold by defendants furnished sufficient proof that they could have been sold by plaintiff. * * *" (at 947)
>
> "* * * it is apparent that defendants had no intention of respecting plaintiff's rights under the contract and considered that they could violate them

> with impunity. Are they to be allowed in such a case to sell at what would have been the cost of the goods to plaintiff and to say to it 'there was no profit in the sales and therefore you have not been hurt'? Are they to be allowed to obliterate their contract and free themselves from their obligations by such an unfair means? If such is the law an exclusive agency contract affords the agent no protection against a principal who chooses not to respect it. An agent would be at the mercy of the principal who came into the exclusive territory and sold to others at the same prices he charged his agent for like goods. The principal would have a convenient and inexpensive way of ridding himself of an undesirable contract. * * *" (at 947)

In *Schiffman v. Peerless Motor Car Co.*, (1910) 13 Cal App 600, 110 Pac 460 at 462 the court said:

> "* * * Another element entering into the consideration of such a question is that of the estoppel of defendant to deny that plaintiff would have made sales of these machines but for its violation of the contract. It does lie in its mouth to say, 'You could not have sold these machines if I had filled your orders and had not devised a method whereby your employés could make these sales through another agency.' "

3. Defendant had two defenses to the charge that its outside sales constituted a breach of its contract obligations. The first was that plaintiff might have placed orders referred to it by defendant with another mill, because Mr. Fields and Mr. Johnson controlled a second sales company which sold for their own plywood plant,

and Mr. St. Onge worked for both sales companies. This assertion was referred to by the trial judge in his second opinion (R 121).

This was a wholly fictitious issue. There was no contention and no evidence that any order was ever diverted by plaintiff from defendant to any other plant or that any order referred to plaintiff by defendant was not filled from defendant's production whenever its order file permitted. To do so would have breached plaintiff's duties to defendant under the contract—specifically, its express and implied duty, as a selling representative, to secure business for the mill in good faith (2 Tr 197). See, for example, *Cowley v. Anderson*, (CCA 10 1947) 159 F2d 1 at 3 in which the defendant-manufacturer was sued for breach of a distributorship contract and contended that the contract was void, because the distributor was not required to buy anything and the amounts of products involved were not ascertainable. The court held:

> "* * * By accepting the exclusive agency for the sale and distribution of the product over a fixed period of time, Anderson & Spilman impliedly agreed to purchase from Cowley all of the product needed to fill the orders obtained. * * *"

See also, *Mills-Morris Co. v. Champion Spark Plug Co.*, (CCA 6 1925) 7 F2d 38 at 39:

> "* * * Plaintiff had an established trade, and there was implied in the language referred to an

obligation to buy from defendant all the plugs that plaintiff should actually, in good faith, and in the normal course of its business, require in supplying its trade. * * *"

In *American Distributing Co. v. Hayes Wheel Co.*, supra. (DC ED Mich 1918) 250 Fed 109, rev'd on other grounds (CCA 6 1919) 257 Fed 881 the contract provided that the distributor "will undertake the sale of your wheels * * * for the entire United States". The court said:

"* * * This clearly contemplated that plaintiff would at least 'undertake' to secure and submit to defendant certain orders. * * *" (at 114)

"I am of the opinion that by the terms of this contract the parties must be held to have agreed impliedly, if not expressly, that plaintiff would exercise good faith and reasonable diligence in obtaining orders for submission to and acceptance by defendant during the term of the contract, and the contract, therefor, is not open to the objection that it lacks mutuality. * * * " (at 115)

In *Automatic Vending Company v. Wisdom*, (DC Cal 1960) 182 Cal App 2d 354, 6 Cal Rptr 31 at 33 a supplier's discretionary power to change the distributor's rate of commission was held not to render the contract unenforceable.

"* * * the power given to the Automatic Vending Company to change the commission rates upon written notice would impose a duty upon it to exercise that discretion in good faith and in accordance with fair dealings and fix the commissions in such amount as the object of the contract is reasonably worth. Therefore, it cannot be said that the contract

in question is illusory, lacks mutuality of obligation, or is void."[58]

Plaintiff not only did not do what defendant claims it might have done; it could not have done so without being guilty of the same business piracy practiced so successfully by defendant.

Defendant's second defense to the charge that its outside sales breached the contract was that plaintiff knew about them all along and had therefore waived its rights. This, too, was mentioned inconclusively by the trial judge (R 119).

The testimony was uncontradicted that the volume of these sales and the identity of the customers were unknown to plaintiff prior to the lawsuit, and that it insisted on its rights whenever defendant's conduct came to its attention. Defendant admitted that it did not disclose these sales to plaintiff and that when plaintiff learned that defendant was accepting outside orders, specifically, orders to its own customers, it protested vigorously and secured verbal assurance that it would not happen again. Plaintiff repeatedly pointed out to defendant that the contract would not work if any other course were followed (Exhs 18, 19).

The admitted facts in this case are that defendant developed its own sales organization and solicited

58. See also *Long Beach Drug Co. v. United Drug Co.*, (1939) 13 Cal 2d 158, 88 P2d 698 at 701, placing an implied duty on the distributor to "purchase and keep on sale a supply of defendant's products sufficient to meet the demands of the retail trade for these particular remedies," citing California Civil Code §§ 1655, 1656.

orders, that it made sales in large volume to plaintiff's customers, actual and potential, at prices which plaintiff could not meet, and that it did so while insisting on a relatively high price level at which plaintiff could not sell all of the production of defendant's mill. It did so without telling plaintiff that the sales were being made and after plaintiff had repeatedly insisted that all inquiries be referred to it. It thereby subverted and destroyed the contract which had enabled it to enter the business at all.

It follows that the trial court erred in holding that the outside sales did not constitute a breach of contract. The contract could not conceivably work if the supplier used a separate sales organization and solicited accounts identified for it through plaintiff's prior efforts. The contract permission to make direct sales of surplus production does not embrace the deliberate course of conduct in which defendant engaged to acquire plaintiff's business and prevent it from receiving the fruits of its investment and its continuing efforts on defendant's behalf.

VI

The trial court arbitrarily decided the case on the basis of issues which were not properly before it.

The procedure followed by the trial court in this case was novel. The problems which result are not limited to the confusion resulting from incorporating ill-defined parts of the first opinion in the second opinion by reference and then entering formal findings and conclusions,

tendered by defendant's counsel insofar as they may be found not to be inconsistent with the second opinion.[59]

The trial judge turned the claim for executory enforcement wholly on an issue which was not raised in the pleadings or asserted in the pretrial order, an issue which he once indicated should not, for that reason, be considered (R 80). In his order granting a partial new trial, he expressly excluded the issue from the further proceedings (R 89). He next referred to it at the end of the partial retrial (2 Tr 708), apparently relying on the evidence of both parties that the five-mill formula was intended to apply to douglas fir as well as digger pine plywood. That evidence did not, however, bear at all on the alternative grounds (not dictum) on which the judge had relied in sustaining the validity of the contract (R 82-83), and no prior warning or notice was given anyone that the question of validity and enforceability was involved in the partial new trial.

Although it has been held to be discretionary with the trial court whether to consider an issue not presented in the pretrial order (*American Pipe & Steel Corpo-*

59. This court once held that where formal findings are entered without more, "they alone" constitute the findings, as distinguished from the court's prior opinion. *Ohlinger v. US*, (CA 9 1955) 219 F2d 310. It has since held that a memorandum opinion can supplement otherwise inadequate formal findings. *Stone v. Farnell*, (CA 9 1957) 239 F2d 750 at 755; *American Pipe & Steel Corporation v. Firestone Tire & Rubber Company*, (CA 9 1961) 292 F2d 640 at 642. In this case, the trial judge entered a separate order expressly stating that the formal findings were subordinate to his second opinion.

ration v. Firestone Tire & Rubber Company, supra, (CA 9 1961) 292 F2d 640 at 643)[60], the procedure employed in this case was misleading and therefore improper, for the trial judge first suggested that the issue was not in the case at all, but resolved it in plaintiff's favor on grounds which had nothing to do with the evidence at the retrial[61] and which were not in issue at the retrial. He excluded the question of validity and enforceability of the contract from the partial retrial and then, after it was all over, reversed his prior ruling and decided it against plaintiff.

This procedure was disorderly and went farther than merely making the appeal cumbersome and difficult. It made the case turn on an issue which was in fact not in issue, one which was beyond the contentions of the parties and which the court had expressly refused to reconsider before the partial retrial took place. Plaintiff had unquestionably sustained heavy damages from defendant's conduct, but the result of the trial court's procedure was to deny it any relief at all.

No cases have been found considering this procedure. However, in the somewhat similar case of *Phelan v. Middle States Oil Corp.*, (CA 2 1954) 210 F2d 360 at 366-367 the court said:

60. See also 29 FRD (1961) 191 at 375. However, the procedure of limiting the issues to those presented in the pre-trial order has repeatedly been approved. *Walker v. West Coast Fast Freight, Inc.*, (CA 9 1956) 233 F2d 939; *Fowler v. Crown-Zellerbach Corporation*, (CCA 9 1947) 163 F2d 773 at 774; Anno: 22 ALR 2d (1952) 599 at 611.

61. That the five-mill formula was a subsidiary provision of the contract.

"* * * Where the motion raises only a question of law, we have no doubt that Rule 59(a)(2) permits a court to reverse completely its prior judgment and give judgment for the other party, if the evidence taken at the trial justifies it. But where new facts are presented in support of the motion for a rehearing, we think that normally at least there should be a trial of those facts before a judgment based on them is entered in favor of the movant. * * * Conceivably, had a new trial been granted as to the issues raised by the cross-claim, the cross-claimant might have been able to require the production of all the records in the possession of these affiants and might have discovered other documents more favorable to its case than those picked out by them. Upon the original trial the court had sustained the cross-claim; the new evidence submitted by affidavit caused the court to change its judgment. * * * We think the cross-claimant is entitled to have the evidence which produced a change in the judgment tested by trial in open court. * * *"

In *Meadow Gold Products Co. v. Wright*, (CA DC 1960) 278 F2d 867 at 869 the court discussed the need for parties to disclose the issues before trial in the following terms:

"In view of all these developments, the courts are not to be lenient with counsel who fail to reveal the theory of their case until all the evidence is closed. Here both defense counsel and the trial judge expressed surprise. That an experienced trial judge should be unaware of the theory of plaintiff's case until that point in the trial cannot be permitted. Where that is done, it is our view that the trial court may, in its sound discretion, grant a mistrial or a reopening and recall of witnesses at the expense of the 'surprising' litigant, if the trial judge considers

> that appropriate in the interests of justice. The theory of a plaintiff's case has much to do with how defendant's counsel will cross-examine plaintiff's witnesses and, perhaps, how he will examine his own witnesses. It is too important a matter to be withheld from the adversary and from the trial judge until all the evidence is in and the case is ready to go to the jury."

We think the foregoing principles relate to issues as well as evidence and apply to judges as well as litigants.

The procedure followed in this case was incorrect and was a prejudicial abuse of discretion by the trial judge.

CONCLUSION

The record on the retrial of this case confirmed the correctness of the trial judge's initial findings and decision in plaintiff's favor. The inability of the parties to apply the subsidiary pricing provision in paragraph 3 never affected their dealings under the contract, and it was at best no more than an alternative guide designed only to assist them when market price could not otherwise be determined. It was therefore clearly wrong for the trial judge to hold that defendant had been discharged from further performance.

Secondly, the records showed that defendant engaged in a course of outside dealing which was incon-

sistent with and subverted the contract and breached defendant's essential obligations thereunder.

The judgment of the lower court should be reversed, and the case should be remanded with instructions to compute and enter judgment for the amount of plaintiff's damages.

Respectfully submitted,

DUNNE, DUNNE & PHELPS
DESMOND G. KELLY

KOERNER, YOUNG, McCOLLOCH
& DEZENDORF

JAMES C. DEZENDORF
JAMES H. CLARKE

Attorneys for Appellant

CERTIFICATE

I certify that, in connection with the preparation of the foregoing brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

_____

Attorney

Appendix A

Exh	Ident	Off	Rec
1		9[1]	9
2		9	11
3		11	11
4		11	12
5		12	13
6A	240	13, 241	241
6B	242	13, 242	242
7		22-23, 581	582
8		23, 400	400
9	105, 187	14, 105, 187, 248	109, 249
10	105, 187	14, 105, 187, 249	109, 250
11	243	14, 244	244
12		14-15, 237	237-238
13		15, 237	237, 238
14		23	207-236
15	49-50	15, 50	52
16	75-76	15, 76	1 Tr 173-174
17		16	
pp 2-3	257	257	259
p 4	262	262	264
p 6	266	266	266
p 7	267	267	268
p 8	268	268	268

1. All references are to the transcript of the partial retrial except where otherwise indicated. Exhibits 1 through 28 were admitted at the first trial, where they bore the same identifying numbers.

Exh	Ident	Off	Rec
18	110-111	16-17, 111	112
19	115	17, 115	116
20	117, 180-181	17, 118, 121, 181	182
21	18	17-18	18
22	1 Tr 183	18	19-20
23	1 Tr 184	20	20
24	269-270	20, 270	270
25	270	20-21, 270	271
26	271-272	21, 273	273
27	273-274	21, 274	274
28	275	275	275
29	33, 101	33, 104	36, 104
30		99	99; see 1 Tr 8-23
31	122, 125	123, 125-126	126
32 through 38		189	189
39	245	245	245-246
40	246	250	250
41	251	252	253
42	254	254	254
43	255	256	256
44	261	261	262
45	279	278	279
46	301-302, 305	308	Rej 308
47		433	433-434
48	594-595	595	595-596

Exh	Ident	Off	Rec
49	596	596	596
50		599	599-600
51		612	611-612
F[2]	45-46, 562	561	562
G	156	156-157	157
H	452	)	
		)	
I	458	)	
		) 527, 591	Rej 591
J	462	)	
		)	
K	465	)	
		)	
L	469	)	
		)	
M	470-471	)	
N	474, 477-478	478	478
O	482-483, 486, 587	487	488
P		538, 591	591
Q	574-575	573	575
R	561	584	585
S	575	576	576
T	585-586	587	587

2. Defendant's Exhibits A through E inclusive were offered and received at the first trial. They were not offered at the partial retrial.

In addition, testimony received at the first trial was received in evidence as follows:

Wilford H. Gonyea	192
F. A. Johnson	345
Laurence V. St. Onge	290
Fred W. Fields	345
Harold D. Olson	345
John A. Beckstrom	345
William D. Schwab	581
Robert H. Schwab	
Keith B. Smith	

Appendix B

SALES AGREEMENT

AGREEMENT made and entered into this 31st day of October, 1955, by and between INTERSTATE CONTAINER CORPORATION, a corporation duly organized and existing under the laws of the State of California with its principal office at Red Bluff, California, hereinafter referred to as "first party" and FRED FIELDS, an individual residing in the City of Portland, State of Oregon, and F. A. JOHNSON, an individual residing in the City of Grants Pass and State of Oregon, hereinafter referred to as "second party";

WITNESSETH:

WHEREAS, FIRST PARTY owns and operates a veneer manufacturing plant located at Red Bluff, California with an estimated productive capacity of veneer of approximately three million square feet per month on a three-eighths inch rough basis;

WHEREAS, FIRST PARTY desires to make arrangements for the addition of certain additional equipment in its veneer plant so that it will be in a position to produce sheathing and other grades of plywood from the veneer it is now manufacturing; and

WHEREAS, SECOND PARTY desires to make arrangements for the marketing throughout the United

States and elsewhere of the plywood to be manufactured by the FIRST PARTY, and during the period while the additional equipment is being acquired to market for the FIRST PARTY its veneer production; and

WHEREAS, SECOND PARTY has sales outlets for veneer and sheathing plywood and customers to serve in principal outlets throughout the United States and elsewhere, and SECOND PARTY also has the necessary finances to acquire the necessary additional equipment to convert the veneer plant to a sheathing plywood manufacturing plant and are able to acquire either new or used equipment to complete the facilities of the FIRST PARTY;

NOW, THEREFORE, for and in consideration of the sum of One Dollar ($1.00) by each of the parties in hand paid, receipt of which is hereby acknowledged, and other good and valuable consideration and the mutual covenants herein contained, IT IS AGREED AS FOLLOWS:

Definitions

For the purpose of this contract, the phrases:

(a) "Veneer" shall mean the veneer produced from logs manufactured by FIRST PARTY in its Red Bluff plant.

(b) "Plywood" shall mean plywood manufactured from pine or other western softwoods native to

the State of California, and in addition shall include plywood manufactured by any method whatsoever.

(c) "Feet" or "square feet" of plywood whenever mentioned in this agreement shall mean "square feet" on a three-eights inch rough basis.

(d) "Market price" to jobbers shall mean the mill price less the (five) 5% functional discount to jobbers.

Example:

Mill Price	$100.00
Less-Functional Discount to plywood jobbers (5%)	5.00
Market Price (listed to jobbers)	95.00
Less Cash Discount (2%)	1.90
Balance	93.10
Less additional discount to SECOND PARTY hereunder	4.66
NET TO MILL	$ 88.44

1. Commencing on the date of this contract SECOND PARTY shall have the exclusive option to buy from FIRST PARTY, 95% of the square feet of veneer or plywood produced in its plant at Red Bluff, California.

2. This agreement shall commence on the 1st day of November, 1955, and shall continue to the 31st day of October, 1960. SECOND PARTY may, at its option,

renew this agreement for an additional five (5) year period by giving notice of its intention to so renew to the FIRST PARTY in writing not less than ninety (90) days prior to October 31, 1960.

3. SECOND PARTY, so far as possible, agrees to provide the FIRST PARTY with orders for 95% of the output of its veneer or plywood. Such orders shall be at the "market price" of veneer or plywood. It is recognized by the parties that digger pine veneer and digger pine sheathing are new products, and it is contemplated that said veneer and sheathing will be sold at the same price as douglas fir veneer and douglas fir plywood. When a "market price" is established, however, in the plants hereinafter named for "digger pine" plywood, such "market price" shall set the "market price" under this agreement. The parties agree that the published market price listed to jobbers by the following plants shall be for the purposes of this agreement the "market price":

United States Plywood Corporation, Anderson, California

Sonoma Plywood Company, Sonoma, California

Tri-State Plywood Company, Santa Clara, California

Industrial Plywood Corporation, Willits, California

Plywood, Inc., Klamath Falls, Oregon

It is recognized that the afore-mentioned mills publish price lists at different intervals and vary their prices by

granting additional discounts. It is intended that the SECOND PARTY obtain orders for the FIRST PARTY at the average of such market price, taking into account the changes referred to herein.

4. SECOND PARTY shall make payment for all invoices to FIRST PARTY fifteen (15) days after the date of mailing of the invoice by FIRST PARTY to SECOND PARTY.

5. SECOND PARTY shall, as near as possible, supply orders to FIRST PARTY to take into account the logs available for veneer and plywood production by FIRST PARTY. FIRST PARTY shall, by the 10th of each month, as far as practical, give to SECOND PARTY its estimated production of plywood by grade and thickness for the following month.

6. In the event SECOND PARTY shall find it is unable to sell 95% of the output of FIRST PARTY for any given month, SECOND PARTY shall, as soon as possible, but in any event give the FIRST PARTY a ten (10) day notice of the portion of the production of SECOND PARTY that it is unable to sell during any month. In the event SECOND PARTY gives such notice, FIRST PARTY shall then be free to sell that portion of its estimated output on the open market through brokers, other than SECOND PARTY, or through its own sales organization for that month.

7. FIRST PARTY shall be free to sell up to (five) 5% of its output in the local trade area. For the purposes of this agreement the local trade area shall be defined as any point within a radius of 20 miles of FIRST PARTIES plant in Red Bluff, California.

8. It is understood that SECOND PARTY will normally take orders for shipment from 15 to 45 days after the order is taken and that SECOND PARTY may be required to commit FIRST PARTY to a price for future shipment. FIRST PARTY shall accept such commitments for a period of up to thirty (30) days and shall be bound to protect the SECOND PARTY on the price on orders accepted for a period of thirty (30) days from the date of the order.

9. All sheathing plywood purchased under this contract shall conform to the grading rules for sheathing plywood which shall from time to time be in force and on file with the U. S. Bureau of Standards, either approved by such bureau or pending such approval. When and if marketing conditions require D.F.P.A. (Douglas Fir Plywood Association) grade marked plywood due to federal or local building codes or rulings, then it is agreed by FIRST PARTY that when its internal financial condition permits and with the approval of SECOND PARTY, it will make application for membership to the D.F.P.A. and, being successful, will use the trade

grade marks owned by the association on that part of the production purchased by SECOND PARTY. In the interim, SECOND PARTY will, upon request, furnish a certificate indicating that plywood purchased by SECOND PARTY conforms to the current or pending commercial standard covering the production of pine plywood. In the event of claim on grade or quality, FIRST PARTY agrees that D.F.P.A. shall serve as inspection agent for the purpose of settling such claims. In the event such inspection shall disclose that the claim of SECOND PARTY of non-compliance of standards is justified, the cost of such inspection shall be borne by FIRST PARTY, otherwise such cost shall be borne by SECOND PARTY, FIRST PARTY further agrees to make such price adjustment as may be meet and proper in the circumstances should the claim of SECOND PARTY justify a price adjustment.

10. The price of plywood purchased by the SECOND PARTY from the FIRST PARTY hereunder shall be the "market price" to jobbers, less 5% and an additional 2% if the invoice is paid in accordance with paragraph 4. The price of veneer purchased by SECOND PARTY from FIRST PARTY hereunder shall be the "market price" less 5% and an additional 2% if the invoice is paid in accordance with paragraph 4. The starting "market price" hereunder is as set out on Exhibit "A" attached hereto. In the event said veneer cannot be

sold at the prices set forth on Exhibit "A", the price shall be fixed by arbitration under paragraph 18 if the parties themselves cannot fix the market price.

11. It is understood that SECOND PARTY contemplates forming a corporation to engage in the business of selling plywood, and that as soon as the organization of such corporation is completed, that they will assign this contract to that corporation. SECOND PARTY shall be released by virtue of such assignment of any obligations under this contract, except the obligation to furnish equipment called for by paragraph 14. In the event of any default on the part of SECOND PARTY on the payment of any obligation on said equipment, FIRST PARTY shall have the right to pay any balance owing on the equipment.

12. Except as qualified by paragraph 11, neither party to this agreement shall assign this contract without the written consent of the other party. Such consent, however, shall not be unreasonably withheld.

13. This contract is subject to acts, requests, or commands of the Government of the United States of America, and of any state, including any municipal subdivision thereof, wherein such delivery or shipment is to be made, and of any qualified board, commission, bureau or department thereof, and all rules and regulations pursuant thereto adopted or approved by said Govern-

ment or any such state, or by any such board, commission, bureau or department thereof, and FIRST PARTY'S performance of any such accepted orders under this contract is contingent upon and FIRST PARTY is not liable for delay or non-shipment or for delay or non-delivery occasioned by acts of God or civil commotions, destruction, or incapacitation of mill or mills supplying said material for FIRST PARTY, fire, earthquakes, epidemics, disease, restraint of princes, floods, snow, storms, strikes, lockouts or labor disturbances, or from any other cause whatsoever, whether similar to the foregoing or not, beyond the control of the FIRST PARTY. With respect to any order placed and accepted under this contract, if shipment is prevented by any of the aforementioned causes throughout the period specified in such order for shipment, such excuse for non-performance is permanent and said order is deemed cancelled unless expressly extended in writing by both parties hereto.

14. SECOND PARTY agrees that it will acquire, as soon as possible, the following equipment for installation in the plant of FIRST PARTY at Red Bluff, California, and SECOND PARTY further agrees to pay all costs of delivering the equipment to the plant of FIRST PARTY. The equipment may be new or used, but in any event must be in good mechanical condition and capable of performing the work normally required of

such new equipment, which said equipment shall be as follows:

(1) Cold press and accessories capable of producing panels of a dimension of not less than 4 feet by 8 feet.

(2) Glue spreader and accessories capable of producing panels of a size not less than 4 feet by 8 feet.

(3) Jointer machine and accessories.

(4) Tape machine and accessories.

In addition to the delivery of the afore-mentioned machines, SECOND PARTY agrees to advance to FIRST PARTY the sum of Ten Thousand Dollars ($10,000.00) to be used to install said machines in the plant of FIRST PARTY at Red Bluff, California. FIRST PARTY agrees to cause said machines to be installed as rapidly as possible after delivery of same by SECOND PARTY. In the event the installation costs shall exceed Ten Thousand Dollars ($10,000.00), such additional cost shall be borne by FIRST PARTY. In the event FIRST PARTY shall cause the installation to be made for less than ($10,000.00) Ten Thousand Dollars FIRST PARTY shall be entitled to retain the difference as a part of its operating capital.

15. SECOND PARTY shall keep an accurate record and obtain receipts on purchasing each machine set out

in the preceding paragraph and shall obtain from the carrier delivering the equipment to the plant of the FIRST PARTY, a receipted freight bill. After the aforementioned machines have all been delivered to the plant of the FIRST PARTY, and SECOND PARTY has advanced the sum of Ten Thousand Dollars ($10,000.00) due FIRST PARTY, SECOND PARTY shall supply FIRST PARTY with an itemized statement of sums advanced for the purchase of said machines, plus the Ten Thousand Dollars ($10,000.00) advanced for installation. FIRST PARTY agrees to repay said sum, plus 6% interest from the date said equipment begins operation, at the rate of Two Dollars ($2.00) per thousand feet of plywood produced at the plant of FIRST PARTY. In any event, however, said sum shall be repaid within 2 years, plus such additional time as the plant of FIRST PARTY may be shut down for reasons set forth in paragraph 13, but in any event, within 3 years.

16. Title to said equipment shall remain in SECOND PARTY or its assigns until fully paid for by FIRST PARTY.

17. FIRST PARTY agrees to keep the said machinery insured, against loss from fire or extended coverage, at its full insurable value, or at least in a sum equal to the unpaid balance due to SECOND PARTY. SECOND PARTY shall be supplied with a copy of said insurance policy.

18. It is hereby agreed that in case any disagreement or difference shall arise at any time hereafter between the parties hereto in relation to this contract either as to the construction or operation thereof, or to the respective rights and liabilities thereto, such disagreement shall be submitted to the arbitration of three persons, one to be appointed by each party to this agreement, and the third to be appointed by the two so appointed. If either party shall refuse or neglect to appoint an arbitrator within 5 days after the other party shall have appointed its arbitrator, and served notice thereof, and of the particular dispute or disputes to be submitted to arbitration upon the other party, requiring it to appoint its arbitrator, then the arbitrator so first appointed shall have the power to proceed to arbitration and determine the matter or disagreement or difference as if he were the arbitrator appointed by both parties hereto for that purpose and his award in writing shall be final, provided such award shall be made within 20 days after such refusal or neglect of the other party to appoint an arbitrator. In case the two arbitrators appointed respectively by the parties hereto shall fail to agree upon the appointment of a third arbitrator within 10 days after the appointment of the last of such arbitrators respectively suggested by the parties hereto, such third arbitrator shall be appointed in accordance with the arbitration statutes of the State of California. Arbitration

hereunder shall be governed by the laws of the State of California relating to arbitration. Each party hereto shall bear its own expense in connection with any such arbitration, including the expense and compensation of the arbitrator appointed by it, and also one-half of the expense and compensation of the third arbitrator selected hereunder.

19. A waiver by either of the parties hereto of any breach of any of the provisions of this agreement shall be limited to such particular instance, and shall not operate as a waiver of, or be deemed to waive any future breaches of any of the said provisions.

20. Any notice required or permitted to be given under the provisions of this agreement shall be given as follows:

(a) To FIRST PARTY at Red Bluff, California, or at such other address as it may from time to time, in writing, designate.

(b) To SECOND PARTY at 522 Public Service Building, Portland 4, Oregon, or such other address as it may from time to time, in writing, designate.

21. Time shall be deemed to be of the essence of this contract.

22. This agreement shall become binding upon and

inure to the heirs, administrators, executors and assigns of the respective parties hereto.

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be executed on the day and year first above written.

—FIRST PARTY—

INTERSTATE CONTAINER CORPORATION

By_____
President

(Seal)

ATTEST:_____
Secretary

—SECOND PARTY—

_____
Fred Fields

_____
F. A. Johnson

SALES AGREEMENT - EXHIBIT "A"

Market Prices on Pine Veneer FOB Red Bluff, California

C-D GRADE

Thickness	Length	Green Prices	Dry Prices
1/10″	100½″	$11.65	$14.50
1/8″	100½″	14.00	17.50
1/6″	100½″	17.50	21.50
3/16″	100½″	21.50	26.00
3/16″	50″	18.50	22.50

B & B Pine Grade

1/10″			19.00
1/8″			22.00

A & A Pine Grade

1/10″			26.00
1/8″			29.00